PepsiCo, Inc. 1989

Forever Young

Embracing change and focusing on the future

Ah youth...

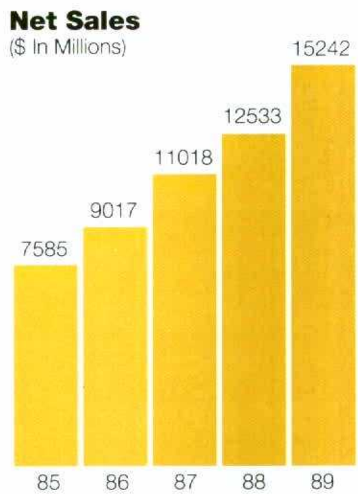
A time of energy and enthusiasm, optimism and adaptability, growth and unlimited potential. Youthfulness... it's more an attitude than an age, but babies seem to symbolize it best.

They're also a great way of saying that, at PepsiCo, we think our best years are still ahead. By embracing change and continually renewing our business, we hope to grow increasingly successful... yet remain forever young.

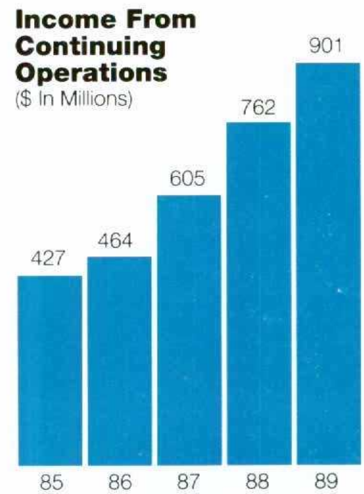
Contents

Financial Summary

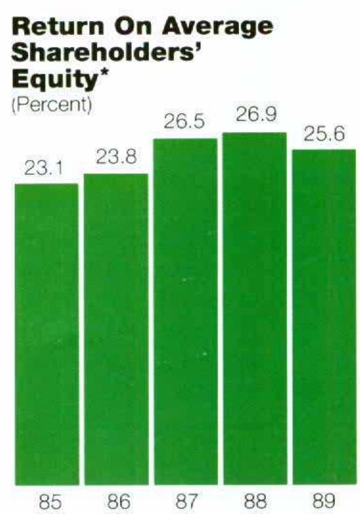
	1989	1988	Percent Change
Net sales	**$15.242 Billion**	12.533 Billion	**+22**
Net income	**$ 901 Million**	762 Million	**+18**
Per Share	**$ 3.40**	2.90	**+17**
Cash dividends declared	**$ 253 Million**	209 Million	**+21**
Per Share	**$ 0.96**	0.80	**+20**
Net cash generated by operations	**$ 1.886 Billion**	1.895 Billion	**–**
Purchases of property, plant and equipment for cash	**$ 944 Million**	726 Million	**+30**
Acquisitions and equity investments for cash	**$ 3.297 Billion**	1.416 Billion	
Return on average shareholders' equity	**% 25.6**	26.9	



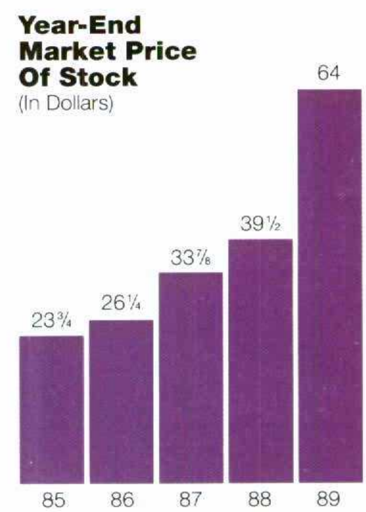
Net sales have grown at a compounded annual rate of 16.6% over the last five years.



Income from continuing operations has grown at a compounded annual rate of 26.3% over the last five years.



The return on average shareholders' equity has averaged 25.2% during the last five years, compared to 15.6% for the previous five years.
*Based on income from continuing operations.



The market price of PepsiCo Capital Stock has grown at a compounded annual rate of 35.5% over the last five years.

PepsiCo, Inc. is a leader in three dynamic and very profitable markets: soft drinks, snack foods and restaurants.

Our businesses – Pepsi-Cola, Frito-Lay, Kentucky Fried Chicken, Taco Bell and Pizza Hut – are among the best known and most successful in the world.

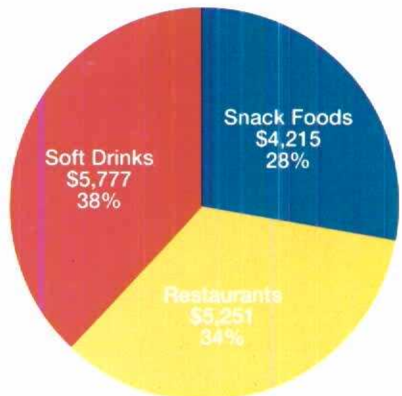
Our products carry some of the best-selling, most-respected and fastest-growing brand names. They are available in nearly 150 countries and account for retail sales of $41 billion.

Despite our size and success, we work to maintain a fresh outlook and an entrepreneurial spirit. Our organization is lean. We keep our most experienced managers close to our customers. We encourage innovation, take prudent risks and demonstrate a bias toward action.

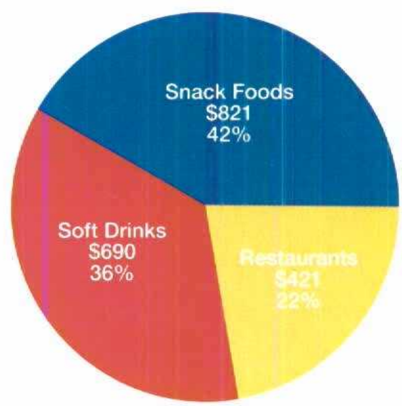
Our basic corporate objective is to maximize the value of our shareholders' investments. We do this through rapid sales growth, close control of costs and wise investment of resources.

These factors made 1989 our best year yet. 1990 will be even better.

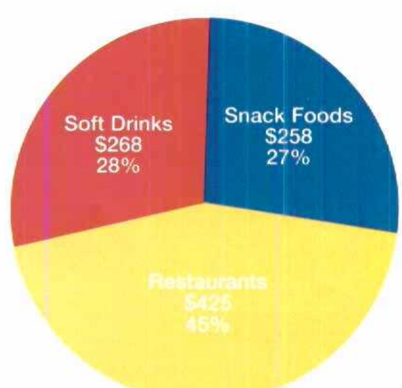
Segment Net Sales
Total: $15,242
($ In Millions)



Segment Operating Profits
Total: $1,932
($ In Millions)



Segment Capital Spending
Total: $950
($ In Millions)



To Our Shareholders and Employees:

PepsiCo in the diaper business? It can't be true. And it isn't.

We put babies on the cover of this Annual Report because they symbolize PepsiCo's commitment to the future.

A quarter century has passed since Pepsi-Cola and Frito-Lay merged to form PepsiCo. We've seen dramatic changes, many of which we initiated. What has not changed, however, is our commitment to excellence and to an operating style that is vigorous, bold and energetic.

Our long-term objective is simple yet ambitious. We want to be the best consumer products company in the world. Our performance in 1989 reflects considerable progress toward this goal:

- Net income rose 18% to $901 million.
- Net income per share was up 17% to $3.40, despite 44 cents dilution from acquisitions.
- Dividends per share increased 20%.
- Sales climbed 22% to $15 billion.
- Strong growth occurred across every business segment, with snack foods profits up 29%, soft drinks up 49% and restaurants up 20%.
- The price of PepsiCo stock rose 62%, dwarfing the 26% increase in the Standard & Poor's 400 index.

What's particularly impressive is that 1989's record performance capped a five-year period during which income from continuing operations grew at a compounded rate of 26% a year.

To us, that's what youthful performance is all about.

Wayne Calloway
Chairman of the Board and Chief Executive Officer

PepsiCo's Philosophy of Self-Renewal

The historian Arnold Toynbee once wrote that "great civilizations grow by successfully responding to successive challenges." Toynbee was describing the process of self-renewal, which I believe should be a passion of organizations and individuals.

At PepsiCo, we embrace change as the essential ingredient of self-renewal. We are constantly doing things differently and fixing things that aren't broken today, before they break us tomorrow.

We focus our self-renewal efforts on three strategic areas – characteristics that in their dimension and dynamics distinguish us from other consumer products companies:

- major brand name products with leadership positions in large and rapidly growing markets;
- operating systems that are extraordinarily complex, yet very efficient; and
- close-in investment opportunities that offer high returns and low risk.

These distinguishing characteristics also offer us sustainable competitive advantages.

Renewing Major Brands

One of our most important competitive advantages is our impressive array of brand names. From Pepsi-Cola to Doritos, Kentucky Fried Chicken to Pizza Hut, our products are synonymous with quality around the globe. These are brands with huge consumer equity. Pepsi-Cola, for example, is the largest-selling food product of any type in U.S. supermarkets, and a $13 billion brand worldwide.

Some might argue that we should not tamper with these brands in either image or substance. We don't agree. We know that in a fast-paced world, today's popular brand

could become tomorrow's trivia question. We're constantly renewing our brands with high-impact advertising, aggressive marketing strategies and innovative product varieties.

This is not change for the sake of change. It is change that generates profitable growth in markets where the demand for our products seems to be virtually unlimited.

What we do with our brands and the way we market them make a real difference. That's why we've expanded home delivery at Pizza Hut, reduced prices at Taco Bell and introduced snack chips at Frito-Lay with one-third less oil. Low-oil Doritos tortilla chips not only broaden the appeal of snack chips to new customers, but also generate increased sales for the entire brand.

Each of these changes expands our reputation for quality, convinces new customers to try our products and strengthens the long-term appeal of our brands. If we didn't make these changes, we'd risk losing valuable consumer equity built over decades.

Improving Our Operating Systems

A second area where our self-renewal efforts pay big dividends is improving the systems we use to produce and distribute our products.

We run the country's largest network of soft drink bottling plants. Our snack food manufacturing and distribution operations are unequaled. And our restaurant system is the largest in the world.

It would be extremely difficult for any competitor to surpass the scope and efficiency of our systems.

But we don't rest on this advantage. We're constantly looking for new ways to improve our operating systems to provide better service at lower cost.

With systems our size, savings suggested by one bottler, restaurant manager or route salesperson can be shared with literally thousands of other employees. In the domestic snack food business alone, we've offset nearly $400 million in cost increases over the past decade through employee suggestions.

Here, again, change builds our business and improves our results.

Investments that Fuel Future Growth

The third strategic advantage that our business offers is the opportunity for high-return, low-risk investments–plus the cash flow necessary to make these investments.

In the past four years, our operating profits have more than doubled and annual net operating cash flow has increased by more than $1 billion. That's enabled us to increase income per share from continuing operations at a compounded rate of 22% a year–and still invest nearly $8 billion in acquisitions to fuel future growth.

Last year alone we invested more than $4.4 billion to acquire 29 U.S. bottling franchises and two of the largest snack chip companies in the United Kingdom, improve our manufacturing and distribution systems, and add more than 700 company-owned restaurants.

In each industry segment, we've moved into new areas, both geographically and strategically. These investments change the size and scope of our company, which in itself promotes self-renewal.

In A Sea of Change . . . One Constant

We're continually renewing our businesses by changing products, improving operations and reinvesting cash flow. But even desirable changes can stretch the fabric of a company. In an unfocused and unsupportive environment, constant change can cause confusion, even chaos.

The only way to manage change to our advantage is with great people, and PepsiCo has 266,000 great people. From a restaurant manager in Sydney to a business planner in Somers, we attract achievers.

Despite differences of language and geography, what keeps us afloat in this sea of change is our values.

We've deliberately set up a system that encourages the values we cherish.

We abhor bureaucracy, disdain memos and prefer the integrity of face-to-face commitments. We try to keep our senior executives close to the real boss: the customer.

We ask our restaurant managers, Frito-Lay packers and Pepsi-Cola salespeople to take ownership of their jobs and treat the company like their own small business.

That's why last year we became the largest company to grant stock options to virtually every full-time employee. We believe our SharePower program will encourage employees, at every level, to look for new ways to increase sales and cut costs.

Because we value self-renewal as a company, our personnel philosophy encourages self-renewal among our employees. Managers who start in snack foods, for example, typically switch to soft drinks or restaurants. The challenges help them grow, while they bring a fresh perspective to their new responsibilities.

The result is a management team that is filled with excitement and new ideas, but also rich in experience. The average tenure on our senior management team is 11 years, and many of our senior executives have worked in at least two of our three businesses.

We look for the same energy and experience in our Board members. We are pleased to welcome Robert E. Allen, Chairman of AT&T, to our Board of Directors. Bob knows about renewal. He's revitalized one of the world's most important technology companies.

The more things change...

PepsiCo enters the 90s a vigorous competitor and a respected industry leader. In Fortune magazine's annual survey of "America's Most Admired Companies," we were ranked sixth out of more than 300 corporations.

But there's still much to be done. For example, although we've nearly tripled our international operating profits in the past two years, they still represent only 16% of our total. In the next decade, PepsiCo will become an even stronger player on a *global* scale.

In every one of our international markets, consumption levels are considerably lower than in the United States. That signals great opportunity. In the Soviet Union, for example, where there are now 24 Pepsi-Cola plants, we sell only as many soft drinks each year as we do in Oklahoma. In Mexico, a $1.5 billion snack market where our sales volumes grew at an annual rate of 33%, the average consumer still eats less than two pounds of snack chips a year, compared to more than 13 pounds for his U.S. counterpart.

With rising prosperity, the growth of television and the changing tastes of world consumers, international demand for our products should explode.

Through strategic acquisitions, like the Smiths and Walkers snack chip companies, and continued investment in our existing operations, we're making the changes necessary to meet that demand.

To reflect the growing importance of our international markets, this Report now includes information on the performance of each business segment outside the United States. In the restaurants segment, we also now provide results by individual system.

As another important addition to this Report, I'm including in the Operating Review my outlook for each of our three businesses.

...the more they stay the same

"Plus ça change, plus c'est la même chose." The saying comes to us from the French, and it applies perfectly to PepsiCo's future. The question we're most often asked about PepsiCo is the same question we ask ourselves: "Can we keep it up?"

I believe the answer is an unequivocal "yes." But continuing performance gains require a strong commitment to corporate self-renewal. That's really what this Report, and PepsiCo, are all about.

Consumer tastes and interests change at such a rapid pace that the marketplace and work environment seem to be in constant flux. Sometimes massive change. Sometimes subtle change. But always change.

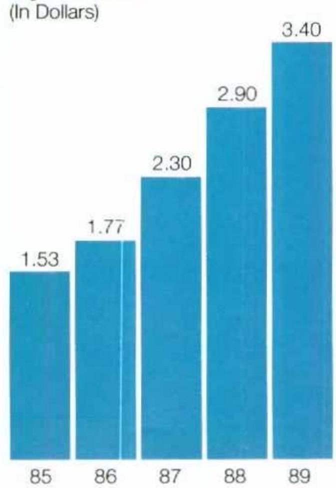
If we remain fast and flexible, change is not a problem; it's a huge opportunity.

I see a future filled with even more opportunity than the past. We can achieve our goal of being the best consumer products company in the world if we remain youthful in action and in spirit–and continue to embrace change. Our pledge to shareholders is to do exactly that–to do everything in our power to stay forever young.

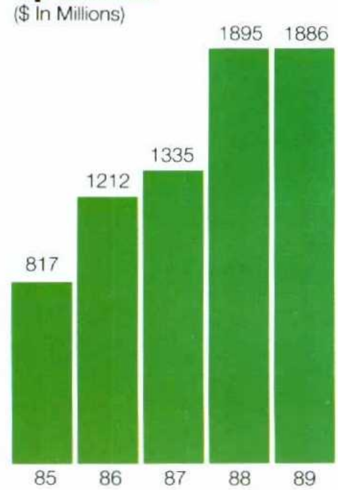
Wayne Calloway

Wayne Calloway
Chairman of the Board and
Chief Executive Officer
February 22, 1990

Income Per Share From Continuing Operations
(In Dollars)



Net Cash Generated By Continuing Operations
($ In Millions)



Staying Young By Embracing Change

Embracing change can't be an empty phrase. It must be a commitment to action. Consider some of the actions we took in 1989:

- Invested $3.4 billion in strategic acquisitions to fuel future growth.
- Tied employee interests even closer to shareholder interests by awarding stock options to virtually every full-time employee, the largest company to do so.
- Reformulated Diet Pepsi to capitalize on the explosive growth in diet soft drinks.
- Acquired 29 U.S. bottling franchises to improve operating efficiency and marketing impact, including a $1.8 billion purchase from General Cinema.
- Restructured international soft drink operations into six divisions to improve response to local opportunities.
- Introduced Diet Mountain Dew nationally, and developed three new beverage products – H_2Oh!, Pepsi A.M. and Mountain Dew Sport.
- Negotiated a new franchise agreement with the U.S.S.R. that will double Soviet sales of Pepsi-Cola in the 90s.
- Accelerated expansion into Europe with a $1.3 billion acquisition of two top snack chip companies in the United Kingdom.
- Decentralized Frito-Lay's operations into four major units to improve overall efficiency and increase local impact.
- Expanded line of low-oil snacks and introduced a multigrain snack chip.
- Pioneered new technology to provide Frito-Lay managers specific sales data generated daily by a network of handheld computers.
- Added more than 1,100 restaurants to what is already the largest system in the world.
- Developed portable Pizza Hut kiosks for hotels, airports, cafeterias, hospitals, schools and stadiums.
- Reorganized KFC domestic operations to improve customer service.
- Generated a 33% increase in customer visits to Taco Bell with a new value-oriented menu.
- Expanded Pizza Hut Delivery, doubling profits in this high-growth distribution channel.
- Opened the 3,000th U.S. Taco Bell and the 3,000th overseas KFC, and introduced Pizza Hut in five additional international markets.
- Improved financial disclosure by providing individual results for our restaurant systems and by identifying international sales and profits within each of our three business segments.

Whew... and these are just a few of the things we did to renew our business. Read more in the Operating Review.


PEPSI

Pepsi-Cola Company
Pepsi-Cola International

	$ Millions	% Change
Sales	5,777	+25
U.S.	4,623	+26
Foreign	1,154	+19
Operating Profits	690	+49
U.S.	587	+43
Foreign	103	+93

Operating Highlights

- **Worldwide retail sales of brand Pepsi-Cola climb to more than $13 billion.**
- **Diet Pepsi marks its sixth consecutive year of double-digit growth.**
- **National introduction of Diet Mountain Dew is completed.**
- **Pepsi-Cola test markets new products, including Pepsi A.M., Mountain Dew Sport and H_2Oh!**
- **Acquisitions of 29 domestic bottling franchises provide significant gains in efficiency, further improving Pepsi-Cola's operating margins.**
- **Operating efficiencies in the areas of raw materials, manufacturing, distribution and technology will save an estimated $25 million.**
- **Pepsi-Cola International reorganizes operations into six divisions, putting experienced managers even closer to our customers.**
- **Contract with new bottling partner in Spain continues to build a foundation for strong growth in Europe. Expansion continues in the Soviet Union, India and China.**

Volume is on a calendar year basis, directly comparable to 1988.

Both domestic and international soft drink operations achieve record sales and operating profits, and increase profit margins.

Market Position

Soft drinks now account for one-fourth of all beverage consumption in the United States. In 1989 consumption was more than 46 gallons of soft drinks for every man, woman and child. Total industry sales of some 7.7 billion cases accounted for estimated retail sales of $43 billion.

In international markets, industry volume was estimated at nearly 13 billion cases, about 70% larger than the U.S. market. Per capita consumption is still relatively low but is growing as soft drinks become more readily available and more widely promoted.

Pepsi-Cola products continue to show strong growth in both the domestic and international soft drink markets. Pepsi-Cola brands account for about $14 billion in U.S. retail sales–about one-third of the total market. Volume in the Pepsi-Cola system grew 3.5%–some 50% better than industry growth of 2.3%.

Pepsi-Cola brands, including 7UP internationally, are available in nearly 150 countries and account for about 15% of the market outside the United States. Our international volume increased more than 4%.

Strategies for Staying Young

Marketing

We build sales and set the standard for consumer excitement in the soft drink market by continu-

ously updating our brands and the ways we advertise, market and distribute them. During 1989 four key strategies raised our sales to record levels.

1. Create market excitement

Perhaps more than any other product, brand Pepsi – despite being almost 100 years old – is identified with youth, refreshment and enjoyment. We've built Pepsi into a $13.4 billion worldwide brand with Pepsi Generation advertising that's known around the globe. Today brand Pepsi is the largest-selling soft drink in U.S. supermarkets, the largest distribution channel for soft drinks. In fact, brand Pepsi is the largest-selling brand of all food products in U.S. supermarkets.

We've achieved marketing success by developing advertising, promotions and events that create excitement and capture the imaginations of our consumers. As a result, Pepsi-Cola advertisements continually rank among the highest in consumer recognition.

In 1989 we continued this tradition with advertising that featured stars such as Michael J. Fox and innovative promotions with Nintendo, one of the year's most heavily promoted video games. Around the world, young consumers flock to Pepsi-Cola sponsored rock music concerts. And after the opening of the Berlin Wall, we captured worldwide attention with a Pepsi-Cola advertisement celebrating the historic event.

2. Sharpen our focus on Diet Pepsi

The diet category has been a growth leader in the soft drink industry for the last five years, growing at a compounded annual rate of more than 10%. Diet soft drinks now account for about 28% of the total U.S. market, up from 23% only five years ago.

We're capitalizing on this growth by sharpening our focus on Diet Pepsi. Since the early 1980s, we've been expanding the historically female market for Diet Pepsi by also appealing to male consumers through sponsorship of sporting events. As a result Diet Pepsi's growth has outpaced the diet category, and it is now the industry's fourth largest brand.

This was the sixth consecutive year of double-digit growth for Diet Pepsi. Despite this success, we took the bold step in 1990 of introducing a new taste for Diet Pepsi. The new formulation is preferred over the competition and is expected to accelerate Diet Pepsi's growth.

3. Expand the market for Mountain Dew

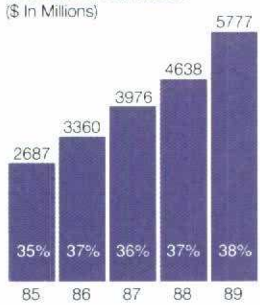
During the last two decades, we've focused on developing a unique taste and image for Mountain Dew. As a result, Mountain Dew is now the U.S. industry's seventh largest soft drink brand.

In 1989 we completed national introduction of Diet Mountain Dew. Now as loyal consumers grow older and more concerned about calories, they can continue to enjoy Mountain Dew in a one calorie form.

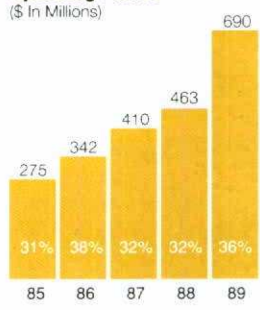
4. Develop new categories

During the last five years, double-digit increases in per capita consumption of bottled water have been the norm. In 1987 we entered this high-potential

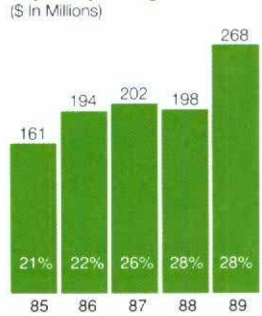
Soft Drinks Net Sales
% Of Total Net Sales
($ In Millions)



Soft Drinks Operating Profits
% Of Total Segments Operating Profits
($ In Millions)



Soft Drinks Capital Spending
% Of Total Segments Capital Spending
($ In Millions)



category and began testing various products and distribution methods. In 1989 we began test marketing three flavors of H_2Oh!, a new sparkling water product. Initial results are promising and we're introducing more consumers to the product. In addition, our huge operating systems provide a competitive advantage. While most companies in the water category have only limited distribution, we can use our entire bottling system to rapidly expand retail distribution.

Another high-potential segment is the morning market. Coffee consumption has declined by nearly one-third in the last 20 years as more consumers are waking up to an alternative. Our entry is Pepsi A.M., with lower carbonation levels and a special flavor developed for the morning. Pepsi A.M. has been successful in test markets, and we're now planning to expand distribution.

Our third new product entry is in the sport drink category, which has grown at a compounded annual rate of 30% over the last five years. Mountain Dew Sport combines the taste of Mountain Dew with the fluid replacement benefit of sport drinks. This product renews our Mountain Dew brand in two ways: by reaching new consumers interested in health and fitness, and by further extending the Mountain Dew trademark. Mountain Dew Sport in both regular and a two calorie version is currently in test markets.

Operations

A key goal is to increase profits by reducing costs and raising margins. Even though our operations are strong, we continuously look for new ways to become more productive and to serve our customers even better. These strategies helped us achieve our goals.

1. Build an operating structure that keeps us close to consumers

In 1988 we decentralized our domestic soft drink operations into four divisions, each responsible for the full range of sales and operating activities within a geographic region. The divisions are united by national marketing strategies that are translated into local programs.

The results include more effective planning for each localized market, faster decision-making and more direct customer contact. Ideas that work well are expanded from area to area, with each division tailoring them to particular markets.

In 1989 we reorganized our international operations to achieve similar results, with Pepsi-Cola International now comprising six regional divisions. Each area faces unique competitive situations. For example, annual per capita consumption averages nearly 30 gallons in Mexico, but is less than one gallon in the Soviet Union. Our new structure adapts to each situation. We've put senior management closer to the local markets, and encouraged them to develop programs that meet the market's special needs.

2. Implement operating efficiencies across the entire system

Our soft drink system is huge and complex, with more than 900 company-operated and franchised bottling plants worldwide. Company-operated trucks alone total more than 22,000 vehicles. In such a large system, even small improvements produce big

Worldwide Brands

Estimated 1989 worldwide retail sales of our largest brands.

$13.4 BILLION

$3.3 BILLION

$1.8 BILLION

$1.1 BILLION
(International)

gains. In 1989 changing our operations resulted in cost reductions that will save an estimated $25 million over the next two years.

We're focusing on three major areas to further reduce costs.

1. Raw materials: We're forming business alliances with the best suppliers in each industry – those who are on the leading edge in technological investment and cost management. By building long-term relationships, we've been able to reduce our suppliers' costs, and therefore reduce our own costs.

2. Manufacturing and distribution efficiencies: Most cost-saving ideas have been suggested by our own employees. As their ideas are developed and perfected, we introduce these improvements throughout the entire system. This multiplies the effect and savings, and also serves to generate still more ideas. Examples include new manufacturing techniques, delivery consolidations and innovative warehousing methods.

3. Technology: We take advantage of the wide range of technological advances introduced throughout our operating divisions. Several years ago we introduced hand-held computers in our snack food business to more closely track sales and better match our manufacturing and distribution schedules to customer needs. This allows our snack foods sales force to make sure there is product on the shelves when the consumer wants it. The result has been higher sales and lower product waste. Now we've begun to introduce hand-held computers in our soft drink business. We expect to see similar improvements.

Investment

We're reinvesting cash flow to expand operations and generate more opportunities. Acquisitions can improve the scope and efficiency of our system, as well as stimulate growth. Here are two key ways we revitalized our soft drink operations.

1. Acquire domestic bottling franchises to increase our efficiency

In 1989 we continued to consolidate our vast bottling system to improve operating efficiency. We acquired 29 U.S. bottling franchises. The largest transaction was the $1.8 billion acquisition of General Cinema Corporation's bottling operations.

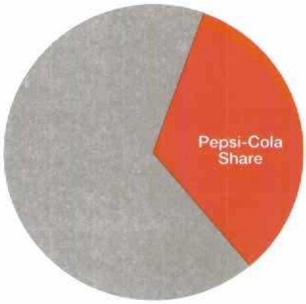
Consolidating territories gives us greater flexibility in promotional activities. It also enables us to take advantage of purchasing, manufacturing and distribution efficiencies across more of our system. For example, in St. Louis alone, distribution efficiencies saved $5 million. As a result, we're able to be very competitive in a price-sensitive market. This led to substantially increased sales volume.

Today company-operated bottling operations handle about half of all domestic Pepsi-Cola volume. We also have an equity position in 77 other franchises, representing another 20% of the bottling business.

2. Maximize growth opportunities in international markets

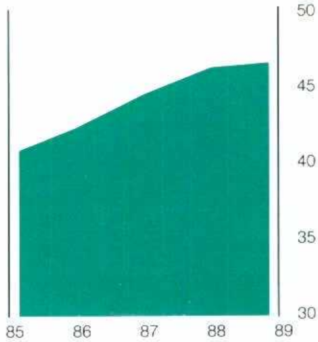
To take full advantage of the enormous long-term potential for soft drinks in international markets, we're establishing partnerships with strong local busi-

U.S. Soft Drink Industry Retail Sales Pepsi-Cola Share



U.S. retail sales of soft drinks now total $43 billion. Pepsi-Cola brands now account for about $14 billion, almost one-third of this huge market.

U.S. Soft Drink Consumption
(Gallons Per Capita)



U.S. soft drink consumption reached a record high of more than 46 gallons per person in 1989.

Chairman's Outlook: Soft Drinks

The soft drink industry has tremendous potential no matter how we view it. Teens and young adults are obviously the major consumers of soft drinks. But per capita consumption has also been growing steadily among other age groups for more than 20 years. That's because people are taking their habits with them as they age. For example, today's 30-to-39 year olds consume three times as many soft drinks per capita as their predecessors in the 1960s.

Regular soft drinks are still the major market, but diet soft drinks are playing an increasingly important role. As people grow older many of them become more concerned about calories, and they turn to diet soft drinks.

That's why we focus on both regular and diet soft drinks–to provide the products our consumers want.

The soft drink industry is one of the most competitive and among the most sensitive when it comes to marketing initiatives and pricing. That's why our strategic focus is based on innovation. We support our brands with high impact advertising and outstanding promotions. We're continuing to introduce new products, as well as aggressively seek opportunities to expand our distribution.

At the same time, we're sharpening our pencils–and our focus–on cost savings and operating efficiencies. Since every dollar saved goes directly into profits, cost savings are the most efficient way to stay price competitive and still boost operating profits.

Sales growth and margin improvements should again produce double-digit growth rates in operating income for us in 1990.

–Wayne Calloway

nesses. Partnerships mean that both parties are focused on the total business system and, as a result, generally produce higher profits. For example, San Benedetto, our franchised bottler in Italy, is growing volume at double-digit levels. Britvic, our joint venture in the United Kingdom, grew volume 27% in 1989. In Spain we entered into a joint venture with KAS, a large Spanish bottler.

We're also establishing strong positions in special opportunity markets. These markets have huge, growing populations with limited competition from other international soft drink companies.

For example, our franchisee in the Soviet Union is expanding production of Fiesta, a lemon soft drink developed specifically for Soviet tastes. The first Pepsi-Cola bottling plant in the Soviet Union opened in 1974. Today there are 24 plants, and we expect to significantly increase sales of Pepsi-Cola during this decade.

In India the first products from the joint venture we signed in 1988 will soon be available to this market of 800 million people.

In China, a country of 1.1 billion persons, our joint venture operations opened a fourth bottling plant. A fifth bottling plant and a concentrate blending facility are under construction.

These activities will enable us to rapidly expand international markets. Despite strong competition, we see high potential. Even in more mature markets, there's still ample opportunity to achieve profitable sales.

Management's Analysis

(Note: The following discussion should be read in conjunction with "Business Segments" on page 34 and "Management's Analysis–Results of Operations" on page 37.)

1989 vs. 1988

Worldwide net sales increased 25% to $5.8 billion. Net sales increased 6%, excluding the net impact of 1989 and 1988 franchised bottler acquisitions, bottling operation divestitures in late 1988 and the third quarter 1989 reconsolidation of a bottling operation in Japan previously held for sale.

Domestic net sales rose 26% to $4.6 billion. Excluding the net impact of acquisitions and divestitures, domestic net sales rose $172 million (5%). Volume growth accounted for half of the increase, with the remainder due to favorable product sales mix and pricing advances in both concentrate and bottling operations. Sales growth was negatively affected by one less week in the 1989 reporting period.

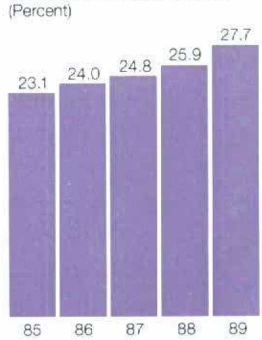
International net sales grew 19% to $1.2 billion. Excluding the impact of the Japan bottling operation and the April 1989 acquisition of a Greek franchised bottler, international net sales advanced $80 million (8%). A broad-based increase in concentrate shipments, with strong growth in key markets, accounted for 70% of the increase. The balance of the improvement was due to pricing advances partially offset by the unfavorable translation impact of the stronger U.S. dollar.

Combined company-owned and franchised bottlers' (systemwide) domestic case sales grew 3.5%, led by strong growth in Diet Pepsi, Mountain Dew and new Mug products, partially offset by declines in Slice products and brand Pepsi. International bottlers' systemwide case sales increased 4% as higher sales in Mexico, Western Europe, the Far East and Canada were partially offset by declines in Venezuela, Argentina and the Philippines. (Bottler case sales growth is presented on a calendar year basis and therefore is not affected by one less week in 1989. The quantification of the impact of volume growth on net sales and operating profits is also on a comparable basis.)

Worldwide operating profits advanced 49% to $690 million. Operating profits were affected by a 1988 domestic reorganization charge and certain other 1989 and 1988 international unusual items. (See Note to Consolidated Financial Statements on page 35.) Excluding the impact of these unusual items, as well as acquisitions and divestitures and the reconsolidation of the Japan bottling operation, worldwide operating profits were up 29%.

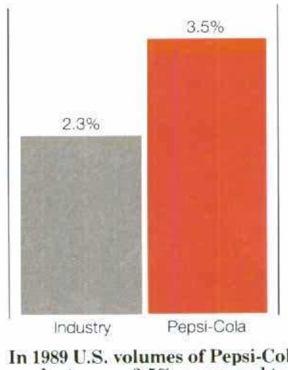
Domestic operating profits increased 43% to $587 million. Excluding the net impact of acquisitions and divestitures and the 1988 reorganization charge, domestic operating profits grew $110 million (27%). Volume growth represented over 25% of the increase. The balance of the improvement was due to pricing advances in both bottling and concentrate operations in excess of cost increases, favorable product sales mix and administrative cost savings, partially offset by the effect of one less week in 1989. The domestic operating profit margin, excluding the impact of the reorganization charge,

Diet Soft Drinks Share Of Total U.S. Market
(Percent)



The diet segment has grown at a compounded annual rate of more than 10% over the last five years. Diet Pepsi volumes grew 70% faster than the diet category.

U.S. Pepsi-Cola System Growth vs. U.S. Soft Drink Industry Growth 1989



In 1989 U.S. volumes of Pepsi-Cola products grew 3.5%, compared to soft drink industry growth of 2.3%.

grew over one point to 12.7% in 1989.

International operating profits rose 93% to $103 million. Excluding the impact of the Greek bottler acquisition, the 1989 and 1988 unusual items, and the reconsolidation of the Japan bottling operation, international operating profits increased $25 million (40%). Led by Canada, Western Europe and Mexico, concentrate volume increases contributed almost $50 million to profit growth; this increase was partially offset by higher promotional and other operating expenses that exceeded the impact of increased prices. The international operating profit margin excluding the impact of unusual items grew over one-half point to 7.2% in 1989.

1988 vs. 1987

Worldwide net sales advanced 17% to $4.6 billion reflecting worldwide volume increases, the impact of several domestic franchised bottler acquisitions and the effect of one more week in the 1988 reporting period. Domestic net sales grew 18% to $3.7 billion reflecting the acquisitions, increased concentrate and fountain syrup shipments, and in bottling operations, volume gains that were partially offset by greater price discounting. International net sales grew 13% to $971 million reflecting strong increases in concentrate shipments to key markets, aided by the favorable translation impact of the weaker U.S. dollar.

Domestic bottlers' systemwide case sales increased 7%, led by significant growth in Diet Pepsi and Mountain Dew and by solid gains in brand Pepsi, partially offset by declines in Slice products. International bottlers' systemwide case sales increased 4%, led by growth in Mexico, the Far East, Western Europe and Canada, partially offset by declines in Argentina. (Bottler case sales growth is presented on a calendar year basis.)

Worldwide operating profits increased 13% to $463 million. Operating profits grew 22%, excluding the impact of a 1988 domestic reorganization charge and certain 1988 and 1987 international unusual items. (See Note to Consolidated Financial Statements on page 35.)

Domestic operating profits grew 13% to $410 million. Excluding the 1988 reorganization charge, domestic operating profits rose 17%. This increase reflected higher volume, favorable product sales mix, increased concentrate prices, the impact of acquisitions and an additional week in 1988, partially offset by increased price discounting in bottling operations. The domestic operating profit margin, excluding the impact of the reorganization charge, was 11.6% in 1988, about even with 1987.

International operating profits increased 15% to $53 million. Excluding the 1988 and 1987 unusual items, international operating profits grew 73% due to operating margin and volume improvements and the favorable translation impact of the weaker U.S. dollar. The international operating profit margin, excluding the impact of unusual items, improved almost two and one-half points to 6.5% in 1988.

Largest Brand In Top-Selling Food Categories in Major U.S. Supermarkets
(Sales in $ Millions)

Brand Pepsi is the leading soft drink in supermarkets and the leading brand of all other food products.

Snack Foods

Snack food sales and operating profits reach an all-time high, and operating profit margins again increase.

Market Position

The snack chip market is growing rapidly, and PepsiCo Worldwide Foods is in a unique position to take advantage of the increasing enjoyment of snacks around the world.

In the United States annual per capita consumption of potato, corn and tortilla chips, cheese puffs, pretzels, nuts and ready-to-eat popcorn exceeded 13 pounds–compared to nine pounds just a decade ago. Retail sales of these snacks climbed to $9.6 billion.

In international markets annual per capita consumption is still less than one pound, but is now growing at about 8% a year. International snack chip retail sales total about $9.5 billion.

Frito-Lay has the largest share of the U.S. snack chip market and is more than four times the size of our nearest competitor. We account for nearly 13% of the U.S. snack industry (including candy, cookies and crackers), a market of about $35 billion in retail sales.

In 1989 Frito-Lay pound volume grew 7%–the highest growth rate since 1980. Sales of our U.S. products grew about twice as fast as the U.S. snack industry.

Outside the United States, PepsiCo Foods International (PFI) is the largest producer of snacks, with a 25% share of the total snack chip market and operations in 19 countries. With our acquisition of Smiths Crisps, Ltd. and Walkers Crisps, Ltd. in the United Kingdom, we now are the leading snack chip company in

Frito-Lay, Inc.
PepsiCo Foods International

	$ Millions	% Change
Sales	4,215	+ 20
U.S.	3,211	+ 9
Foreign	1,004	+ 73
Operating Profits	821	+ 29
U.S.	668	+ 14
Foreign	153	+211

Operating Highlights

- **Frito-Lay volume rises 7%–the largest gain in nine years.**
- **International sales grow 73%, and profits triple.**
- **We decentralize Frito-Lay operations into four business areas to respond rapidly to local opportunities.**
- **PepsiCo becomes the leading snack food company in Europe by acquiring Smiths Crisps and Walkers Crisps, two top snack chip manufacturers in the United Kingdom.**
- **New information technology gives Frito-Lay more useful marketing information faster.**
- **New line extensions build on the success of top-selling Lay's and Ruffles brands potato chips and Fritos brand corn chips.**
- **We acquire Smartfoods, Inc., a ready-to-eat popcorn business that offers one of the fastest-growing snack products in the United States.**
- **Our joint venture builds its first snack food plant in India, a market of 800 million people.**
- **Frito-Lay introduces additional low-oil products and expands marketing into new regions.**

Pound growth adjusted to eliminate the effect of one less week in 1989.

Europe. Even without this acquisition, PFI volume grew 32%.

Strategies for Staying Young

Marketing

Today's consumer has many alternatives from which to choose when a snacking occasion arises. To stay on top we continue to innovate in product, packaging and distribution. During 1989 we implemented three key strategies to keep our sales growing and our products fresh in the minds of consumers.

1. Introduce new flavors of established brands to maintain consumer interest

New flavors of our top-selling brands give consumers the benefits of a new taste in a trusted, familiar product. These line extensions add excitement to our brands. Yet, they are economical to produce since they primarily involve seasoning changes. This makes them very profitable.

Frito-Lay introduced several successful line extensions in 1989, including Ruffles brand Mesquite Grille B-B-Q potato chips, Ruffles brand Ranch flavored potato chips, and Lay's brand Cheddar Cheese flavored potato chips. We completed introduction of Doritos brand Salsa Rio brand flavored tortilla chips and Fritos brand Wild 'N Mild Ranch brand flavored corn chips.

Each of these line extensions is promoted not merely as a new flavor, but as an entirely new product. This attracts new consumers, while reminding consumers of our major brands – Fritos brand corn chips, Ruffles and Lay's brands potato chips, Doritos and Tostitos brands tortilla chips and Chee•tos brand cheese flavored snacks. This strategy keeps these brands securely among the top 10 snack chips sold in U.S. supermarkets.

2. Create new products and new snack segments to meet evolving consumer needs

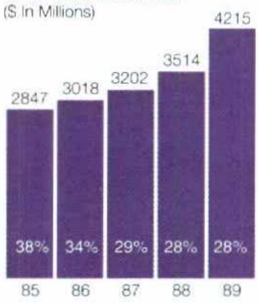
As baby boomers age they continue to enjoy snacks, but their nutritional needs change. To help meet the interests of these consumers, Frito-Lay has created a line of low-oil snacks with one-third less oil than our regular brands on a per ounce basis, and an even more significant reduction on a per chip basis. Like the diet soft drink category, these snacks have the potential to be a major snack segment.

In 1989 we introduced Nacho Cheese and Cool Ranch brand flavored Doritos brand Light tortilla chips west of the Mississippi River. Ruffles brand Light potato chips and Chee•tos brand Light cheese flavored snacks also were introduced in test market. All the brands did so well that they're being expanded nationally in 1990.

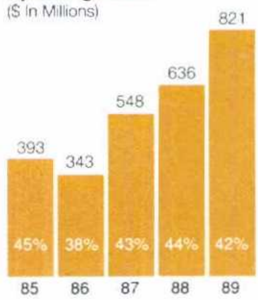
We've also launched what promises to be another important addition to the snack chip segment – multigrain products. Sunchips brand multigrain snacks are made from whole wheat, corn and other natural ingredients. The chips come in two flavors, Original and French Onion. Consumer response in the first stages of testing has been excellent.

One important benefit to Frito-Lay in marketing these snacks is that many retailers have provided additional shelf-space for both low-oil snacks and multigrain snacks, since they regard these products as part of a new snack segment.

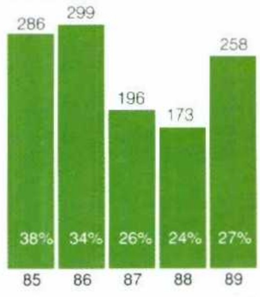
Snack Foods Net Sales
% Of Total Net Sales
($ In Millions)



Snack Foods Operating Profits
% Of Total Segments Operating Profits
($ In Millions)



Snack Foods Capital Spending
% Of Total Segments Capital Spending
($ In Millions)



3. Create new markets through packaging and distribution

New methods of packaging and distribution introduce our products to new consumers. In 1989 we introduced snack chips packed in canisters. These attract consumers who want an easy way to store snacks on the pantry shelf. The canisters are very popular with occasional snackers and do particularly well in outlets such as chain drugstores where snacks are a minor part of the product line.

In 1990 we'll broaden distribution by introducing six varieties of Frito-Lay snacks in canisters to one-third of the United States.

Vending machines are another distribution channel we're growing through innovation. To build our vending sales, we're pioneering the concept of vending machine promotions. For example, consumers who buy Frito-Lay products from vending machines receive a coupon offering discounts off the price of athletic shoes. We're now developing an ongoing promotional calendar to stimulate sales in this market.

Operations

Our operating systems are large and highly complex, and we have a passionate dedication to continuously improve the way we manage these systems. Our focus on operations provides us with a significant competitive advantage, as well as profit improvements. Here's a look at three ways we improved operations in 1989.

1. Move decision-making even closer to our customers

The Frito-Lay system is huge. It includes 38 manufacturing plants, about 1,600 warehouses and a route sales team of 10,000 men and women calling on 400,000 outlets at least once each week. In 1989 we continued to decentralize operations by reorganizing Frito-Lay into four field operation units: North, South, Central and West.

Each field operation unit focuses on serving the regional needs of customers and consumers, and on responding quickly and efficiently to competitive thrusts.

Our major new products and marketing programs are national in scope, so we can take advantage of many economies of scale. At the same time, we execute them locally, so we can respond quickly to area opportunities and develop customized marketing approaches for each major trade account in the region. This combination of national impact with a regional focus is making Frito-Lay an even more formidable competitor.

2. Use technology to improve competitiveness

Key to our success in decentralizing operations is Frito-Lay's pioneering use of information technology. Through a network of computers and information databases, the highly specific sales and marketing information required to make effective business decisions down to a specific city, or even store level, is now widely available throughout the Frito-Lay system.

The process begins right at the point of sale when Frito-Lay's route salespeople use hand-held computers to automatically print a sales receipt. Paperwork is eliminated, but just as important, the sale is recorded on the computer.

Worldwide Brands

Estimated 1989 worldwide retail sales of our top brands.

Doritos

$1.2 BILLION

Ruffles

$1 BILLION

Lay's

$700 MILLION

Fritos

$600 MILLION

Chee-tos

$500 MILLION

At the end of the day, the data in the hand-held computer is transferred to a centralized computer. Information from the entire Frito-Lay sales force is collected there and is available for analysis in as little as 24 hours. This process formerly took as long as one week.

At the same time, market information is collected and entered into the computer system for comparison with Frito-Lay data. This allows sales managers to spot problems, take advantage of opportunities and react quickly to competitive situations.

The newest information tool is a system that condenses the massive amounts of information available and automatically highlights problem areas. This system is currently being introduced to 200 decision-makers throughout the organization.

Since all our managers share the same data base, they can work closely together, even though they're geographically separated. The system gives Frito-Lay the speed and flexibility of an autonomous local business, combined with the perspective and expertise of a centralized national company.

These systems can also significantly improve our ability to gather and analyze information in our international operations, and we've begun to introduce them to selected markets.

3. Accelerate productivity improvements

In a system as large as ours, every productivity improvement – no matter how small – can mean huge savings when introduced throughout our entire snack food operation. Frito-Lay's constant attention to improving productivity has paid off in operating margins that are among the highest in the food industry.

Our Methods Improvement Program, which solicits and implements ideas suggested by employees at every level of the company, continues to produce excellent results, offsetting some $380 million of costs during the decade. In fact, during the last four years, we've increased by 6% per year the amount of product we're producing per labor hour. These savings have enabled us to grow profits while keeping prices competitive.

Investment

Although we're already the largest snack chip business in the world, we're alert to fresh opportunities that will strengthen our business and expand our markets. Here's a look at two ways we invested in our business in 1989.

1. Rapidly expand international markets

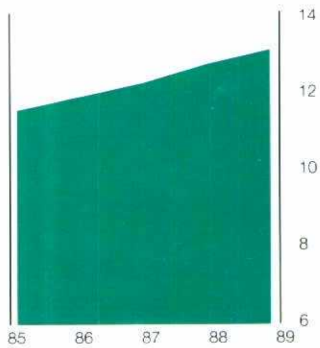
The international snack food market offers tremendous opportunity as snack chips become more widely developed and marketed. We're taking advantage of growing consumer interest to accelerate growth of our operations in two ways.

1. Acquisitions and joint ventures: Our largest acquisition was the $1.34 billion acquisition in July 1989 of Smiths Crisps, Ltd. and Walkers Crisps, Ltd., two leading snack chip companies in the United Kingdom. Together they command a 40% share of the U.K. snack chip market. We plan to grow their businesses even further by increasing per capita consumption, as well as by intro-

U.S. Snack Food Industry Retail Sales Frito-Lay Share

U.S. sales of snack foods total $35 billion. Frito-Lay's share of this market is $4.5 billion, about one-eighth of the market.

U.S. Snack Chips Consumption
(Lbs. Per Capita)



U.S. per capita consumption of snack chips exceeded 13 pounds per person in 1989 and is continuing to grow.

Chairman's Outlook: Snack Foods

The snack market is becoming more exciting every day and we see several trends that will fuel its continuing growth. First of all, consumers are increasing their consumption rates for snack chips. At the same time, they're trying new snack tastes and varieties. Competition is intense, but baby boomers who grew up with our products are familiar with our brand names and trust our quality. We think this gives us a distinctive competitive advantage.

We intend to maintain our solid lead in the U.S. industry by acting like entrepreneurs and embracing change. We've already introduced several varieties of our established brands, and we plan to introduce still more. We're also developing new products, including items geared especially for consumers whose nutritional needs are changing.

But we won't let up on controlling costs. We want to take advantage of every opportunity to fine tune our sales, manufacturing and distribution systems. We should also see some additional efficiencies as the benefits of our new technology spread throughout the organization.

We're also building a strong foundation for our international operations. In areas where we currently have operations, we'll be focusing on increasing sales, introducing more Frito-Lay brands and taking advantage of the economies of scale that develop as we grow larger. In fact, PFI's operating profits are now the highest among our international operations. We'll also continue to expand into new countries.

In 1990 we expect our snack food segment to achieve double-digit sales and operating profit growth. The percentage of sales coming from markets outside the United States will continue to increase.

–Wayne Calloway

ducing many of our global brands into U.K. markets.

Equally important is that, with our operations in Spain, Portugal and Greece, and joint ventures in Italy and Turkey, this acquisition provides a strong foundation for expansion into other European markets.

We're also pursuing opportunities along the Pacific Rim and proceeding with our joint venture in India, where we have constructed a snack chip plant.

2. Growing established markets: In established markets, such as Mexico, Spain and Canada, we're committed to increasing volumes, improving productivity and expanding distribution.

For example, in Mexico we achieved a 33% increase in volume through high visibility promotional programs and the further development of a sweet snack business. In our Korean joint venture, efficiencies of scale helped produce solid operating margins. Our Canadian joint venture has enabled us to broaden distribution of Frito-Lay branded products in Western Canada and the Maritime Provinces.

In each of our markets, we're following our successful strategy of introducing our proven products, manufacturing and distribution systems. As a result, our international snack food system has increased to include some 24,000 employees, 8,000 routes and 39 plants.

2. Use acquisition opportunities to enhance our domestic business

Ready-to-eat popcorn is one of the fastest-growing snack products. In early 1989 we took advantage of an opportunity to tap into this growth with the acquisition of

Smartfoods, Inc., a regional manufacturer of packaged popcorn.

Smartfoods offers an excellent product, and we offer a sales and distribution system that matches the brand's potential. In just one year, volume has nearly doubled as we've introduced Smartfood brand cheese popcorn throughout the Northeast. In 1990 we will begin introducing Smartfood brand popcorn throughout the United States.

Management's Analysis

(Note: The following discussion should be read in conjunction with "Business Segments" on page 34 and "Management's Analysis–Results of Operations" on page 37.)

1989 vs. 1988

Worldwide net sales rose 20% to \$4.2 billion. Excluding the impact of the July 1989 Smiths Crisps and Walkers Crisps (S&W) acquisition and the absence in 1989 of the previously consolidated Canadian operation (contributed to a joint venture in late 1988), worldwide net sales increased 16%.

Domestic net sales grew \$278 million (9%) to \$3.2 billion with strong volume growth contributing over 55% of the increase. The remaining growth was due principally to increased prices. The favorable impact of the Smartfoods acquisition was offset by the effect of one less week in the 1989 reporting period.

International net sales increased 73% to \$1.0 billion. Excluding S&W and the Canadian operation, international net sales increased \$257 million (51%). Strong volume gains accounted for approximately 60% of this increase with the remainder due principally to increased prices, partially offset by the impact of one less week in 1989.

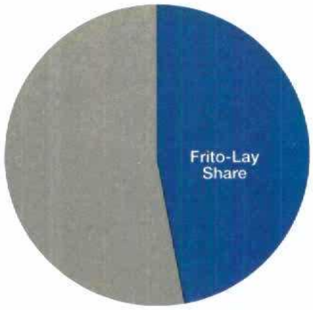
Total domestic pound shipments advanced 7%. This growth reflected the success of new flavor line extensions and was led by increases in Fritos brand corn chips, Santitas brand tortilla chips, Ruffles brand potato chips and Doritos brand tortilla chips. Excluding S&W and the Canadian operation, international snack chips pound growth was up 32%, driven by strong gains in Mexico, Brazil and Spain. (Pound growth has been adjusted to eliminate the effect of one less week in 1989. The quantification of the impact of volume growth on net sales and operating profits is also on a comparable basis.)

Worldwide operating profits were up 29% to \$821 million. Excluding S&W and the Canadian operation, worldwide operating profits were up 24%.

Domestic operating profits grew \$81 million (14%) to \$668 million. Strong volume gains contributed over \$100 million in operating profit growth. This increase was reduced by higher commodity costs, particularly for potatoes and cooking oils, and increased promotional spending, which were partially offset by increased prices. Additionally, domestic results in 1989 were negatively affected by one less week and the net impact of a \$6.6 million reorganization charge that was partially offset by a \$4.3 million credit resulting from a decision to retain a cookie production plant previously held for sale. The domestic operating profit margin grew almost one point to 20.8% in 1989.

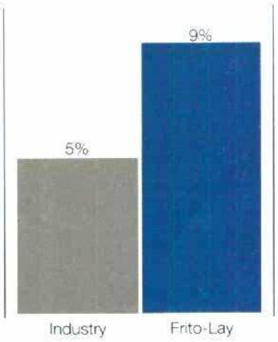
International operating profits increased 211% to \$153 million.

U.S. Snack Chips Industry Retail Sales Frito-Lay Share



Frito-Lay is the world's largest producer of snack chips. In the \$9.6 billion U.S. snack chip and packaged popcorn segment, Frito-Lay accounts for about half of all sales.

Frito-Lay Growth vs. U.S. Snack Food Industry Growth 1989



In 1989 sales of Frito-Lay products grew 9%, compared to snack food industry growth of 5%.

Excluding S&W and the Canadian operation, international profits increased $74 million (151%). Led by Mexico, Spain and Brazil, significant volume gains accounted for over 70% of this increase. The remaining growth was due to increased prices in excess of cost increases. The international operating profit margin jumped almost 7 points to 15.2% in 1989 due principally to volume growth in existing operations.

1988 vs. 1987

Worldwide net sales rose 10% to $3.5 billion. Domestic net sales grew 5% to $2.9 billion, reflecting continued volume growth. International net sales grew 39% to $581 million as a result of volume gains and pricing in line with inflation. Both domestic and international net sales were also favorably affected by one more week in the 1988 reporting period.

Total domestic pound shipments advanced 3%, led by increases in Santitas and Doritos brands tortilla chips, Lay's brand potato chips and Chee•tos brand cheese flavored snacks. International snack chips pound growth was 15%, led by exceptional growth in Mexico and Spain, partially offset by declines in Brazil. (Pound growth has been adjusted to eliminate the effect of one more week in 1988.)

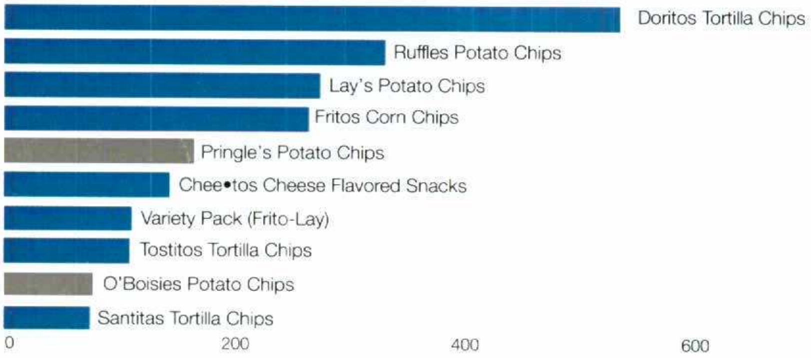
Worldwide operating profits increased 16% to $636 million. Domestic operating profits grew 13% to $587 million, while international operating profits advanced 78% to $49 million. Excluding a $10 million gain in 1987 on the sale of a domestic cookie production facility, worldwide and domestic operating profits increased 18% and 15%, respectively.

Domestic operating profit growth was due primarily to volume growth, manufacturing productivity gains, favorable expense trends and the effect of one more week in 1988. The domestic operating profit margin excluding the gain on the cookie plant sale grew over one and one-half points to 20.0% in 1988.

International profits grew principally as a result of the significant volume increases in Mexico and Spain, the impact of price increases and improved productivity. The international operating profit margin grew almost two points to 8.4% in 1988.

Late in the fourth quarter of 1988, PepsiCo acquired a 50% interest in a joint venture for the production and distribution of snack foods in Canada. The consolidated operating results of PepsiCo's Canadian operations contributed to the joint venture were not significant to industry segment results in 1988 or 1987.

Top-Selling Snack Chips Items In Major U.S. Supermarkets
(Sales In $ Millions)



Eight of Frito-Lay's products are among the 10 best-selling snack chip items in major U.S. supermarkets.
(Based on IRI InfoScan Service® data.)


"it's finger lickin' good"
Pizza Hut.
Makin' it great!
ACO B

Pizza Hut, Taco Bell
Kentucky Fried Chicken
PepsiCo Food Service International

	$ Millions	% Change
Sales	5,251	+20
U.S.	4,685	+19
Foreign	566	+31
Operating Profits	421	+20
U.S.	362	+18
Foreign	59	+34

Sales		
Pizza Hut	2,454	+22
Taco Bell	1,466	+27
KFC	1,331	+10
Operating Profits		
Pizza Hut	208	+36
Taco Bell	113	+38
KFC	100	−14

Operating Highlights

- **PepsiCo restaurant sales and earnings rise 20% despite a sluggish industry.**
- **Taco Bell and Pizza Hut significantly increase their segment share: Taco Bell to 62% and Pizza Hut to 22%.**
- **Taco Bell's value pricing strategies and marketing programs produce record increase in profits.**
- **Pizza Hut expands distribution with new kiosks and delivery operations, almost doubling its share of the delivery segment to 13% in just one year.**
- **KFC domestic operations are reorganized on a regional level to improve efficiency and place more emphasis on customer satisfaction.**
- **PepsiCo restaurant systems reach 18,483 units, enhancing our leadership position in three of the largest and fastest-growing segments of the quick service market.**
- **Pizza Hut continues rapid international expansion, entering five new markets.**
- **KFC opens its 3,000th unit overseas, making it the largest U.S. restaurant chain overseas. Taco Bell opens its 3,000th unit in the United States.**

PepsiCo's combined restaurant operations again outperform the industry, and achieve record sales and profits.

Market Position

U.S. restaurant industry sales were sluggish in 1989, increasing only 6%. While sales growth in the quick service segment of the industry was stronger, rising over 7% to $65.5 billion, the industry is in the process of consolidating. Several smaller and less profitable systems significantly reduced operations or closed. The top 12 chains – including Pizza Hut, Taco Bell and Kentucky Fried Chicken (KFC) – accounted for about 70% of the industry growth.

In contrast, PepsiCo's U.S. system sales grew 14% – about twice as fast as the quick service industry. System sales, consisting of combined company-operated and franchised sales of Pizza Hut, Taco Bell and Kentucky Fried Chicken, totaled $8.3 billion.

Although still largely underdeveloped, the international quick service restaurant industry is growing steadily. In international markets our units accounted for $3.2 billion in system sales and grew more than 18%.

With 18,483 units we're the world's largest restaurant company. Our three categories – pizza, chicken and Mexican food – are among the largest and fastest-growing segments of the quick service market. Our worldwide system sales now top $11 billion.

Pizza Hut is the leading pizza chain in the world. In the $15 billion U.S. pizza segment, the Pizza Hut system has a 22% share, up two points over 1988.

Combined sales of company-operated and franchised units reached $3.3 billion.

Internationally Pizza Hut is in 54 countries around the world and is the leading pizza chain in 46 of these markets.

Kentucky Fried Chicken is the world's largest quick service chicken restaurant system. Its combined company-operated and franchised U.S. restaurant sales of $3 billion represent 50% of the $6 billion U.S. chicken segment. Outside the United States, there are KFC units in 57 countries. They have system sales of some $2.4 billion, bringing KFC total system sales to $5.4 billion.

Taco Bell is the leading U.S. Mexican food chain. Combined company-operated and franchised sales are $2 billion and represent 62% of the $3.2 billion category, an increase of some six points in 1989. We also continue to expand Taco Bell overseas, operating in seven international markets.

Outside the United States, Pizza Hut and Taco Bell operations are managed by PepsiCo Food Service International (PFSI). PFSI accounts for $820 million in system sales.

Strategies for Staying Young

Marketing

Consumers not only cause changes, they also respond to them. We increased our restaurant system sales in 1989 by doing many new things that, taken together, give our customers more value and more reason to return to our restaurants. Here's a look at two key strategies.

1. Provide consumers real value

In many quick service restaurant systems, price hikes have begun to cut into sales as customers wonder if they are getting enough value for their dollars. At PepsiCo's systems we're finding ways to keep customer confidence through value-oriented menus.

For example, Taco Bell research showed that quality food was the reason most customers came into Taco Bell. But many consumers felt that Taco Bell's prices were high, so they didn't come back more often.

To counteract this perception, Taco Bell introduced a value-oriented menu at the end of 1988. This new menu offers a number of items, including the basic taco, at a low price. Once customers understood that this was a permanent low price, not just a temporary price promotion, they started coming to Taco Bell more regularly.

The result of this innovative value strategy has been improved consumer perceptions of price and value, and higher sales and profits.

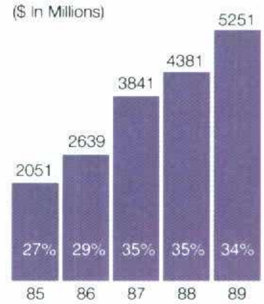
A similar strategy is working at Pizza Hut. The Pizza Hut Pairs program, also a permanent offer, gives consumers two pizzas for one low price. The additional volumes have increased per store sales and profits.

KFC is also testing value programs, such as offering low pricing for double buckets of chicken and pricing several menu items more competitively.

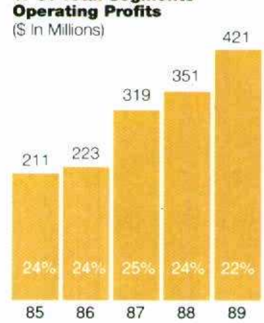
2. Create continuing product and promotion news

New varieties of existing products keep our menus fresh and interesting, just as line extensions

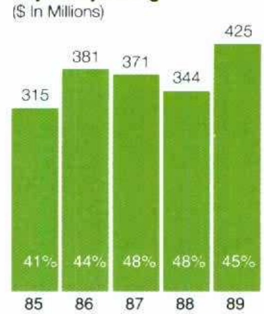
Restaurants Net Sales
% Of Total Net Sales
($ In Millions)



Restaurants Operating Profits
% Of Total Segments Operating Profits
($ In Millions)



Restaurants Capital Spending
% Of Total Segments Capital Spending
($ In Millions)



do in our snack food business. Profitability is improved because the product varieties can be prepared without major kitchen changes. For example, Pizza Hut offers specialty items such as Meat Lover's, Pepperoni Lover's and Cheese Lover's Plus pizzas. At KFC, Hot Wings will be introduced nationally in 1990, following very successful test marketing.

We'll also continue to introduce products to meet changing consumer preferences. KFC is testing Char-grilled chicken, a product developed to satisfy the growing number of consumers who prefer non-fried chicken.

We also stimulate increased awareness of our products and bring customers back through creative advertising and promotions. For example, Taco Bell's promotional tie-in with the hit movie "Batman" contributed to a 45% increase in customer traffic.

Operations

Our systems are large and successful, and the temptation is to leave them alone until some external factor forces change. We don't. Instead, we actively seek change, trying to improve customer service and develop even more efficient operating methods. Here are two ways we do this.

1. Improve customer service

Our most important example of this strategy is at KFC, where our first step in restoring earnings growth is to stress customer service. To do this, we've reorganized our U.S. operations to make them more efficient. We've revised our crew training programs and updated our restaurant operating standards. Our focus is on the basics of good customer service: clean stores, faster and friendlier service, and continued high-quality products.

At Taco Bell we're testing several procedures to further streamline kitchen operations and give our staff even more time to focus on our customers. The result of these test programs has been higher capacity, leading to higher sales and higher customer satisfaction. During peak hours we've been able to cut our average customer service time by as much as 70%. As volumes in the Taco Bell system continue to grow, these measures will help handle the increased sales without additional labor cost or expenditures for bigger facilities.

2. Technological efficiencies

Each of our restaurant systems is using technology to fundamentally change the way we do business, further improving service and reducing costs.

Taco Bell, for example, is quickly moving toward T.A.C.O., or Total Automation of Company Operations. This in-store restaurant computer system eliminates about 15 hours a week of management tasks, leaving more time to devote to customer service.

We're also continuously redesigning our restaurants for increased efficiency. For example, Taco Bell units under construction have only 40% of the total space devoted to kitchens. In 1983 the kitchen took up some 70% of the space. The changes increase customer counts during busy periods since there is more room for dining.

Investments

We've added new life to our restaurants by searching for

Worldwide Trademarks
Estimated 1989 system sales.

Kentucky Fried Chicken
$5.4 BILLION

Pizza Hut
$4.1 BILLION

TACO BELL
$2 BILLION

growth was due primarily to higher pricing both domestically and internationally. Worldwide operating profits declined 14% to $100 million. Excluding the 1989 $8.0 million reorganization charge, KFC's worldwide operating profits fell $9 million (7%). The decline in operating profits principally reflected lower volumes ($10 million). The favorable impact of additional units ($10 million) and higher franchise royalty revenues was offset by higher food and other operating costs in excess of price increases. The worldwide operating profit margin, excluding the reorganization charge, declined one and one-half points to 8.1% in 1989.

Domestic net sales increased slightly primarily due to increased prices, as growth from additional units was offset by declines in volumes. Comparable sales for domestic company-owned units were about even with the prior year. Domestic operating profits declined principally due to decreased volumes and higher food and other operating costs, partially offset by increased prices and additional units. Led by Australia, New Zealand and Canada, international net sales posted strong double-digit growth reflecting additional units, increased prices and solid volume increases. International operating profits grew at a strong double-digit rate principally due to increased volumes, additional units and higher franchise royalty revenues.

1988 vs. 1987

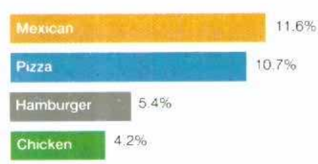
Worldwide net sales increased 14% to $4.4 billion. Domestic net sales grew 13% to $4.0 billion, and international net sales rose 26% to $430 million. These performances reflected additional restaurant and delivery units (both constructed and acquired from franchisees), volume gains, the favorable translation impact of the weaker U.S. dollar and price increases.

Worldwide operating profits rose 10% to $351 million. Domestic operating profits grew 9% to $307 million, and international operating profits were up 17% to $44 million. Domestic operating profits rose 6% excluding an $8.0 million reorganization charge at KFC in 1987. International operating profits rose 47% excluding a $7.5 million gain in 1987 resulting from the sale of several Pizza Hut restaurants in Australia. Worldwide profit growth was primarily due to volume increases and additional units, partially offset by higher operating expenses and lower gains resulting from sales of company-owned restaurants (restaurant resales) in 1988. Total domestic segment gains on restaurant resales represented 1% ($4 million) and 6% ($16 million) of domestic operating profits in 1988 and 1987, respectively.

Net sales and operating profits at Pizza Hut and Taco Bell were favorably affected by one more week in the 1988 reporting period. However, the related growth in comparable sales per domestic company-owned unit presented below has been adjusted to eliminate the impact of one more week in 1988. KFC's results were not affected by one more week in 1988.

Pizza Hut's worldwide net sales increased 15% to $2.0 billion principally due to volume gains and additional units in both the traditional restaurant and delivery operations. Operating profits grew 11% to $153 million. Excluding the Australian restaurant resales gain in 1987, worldwide

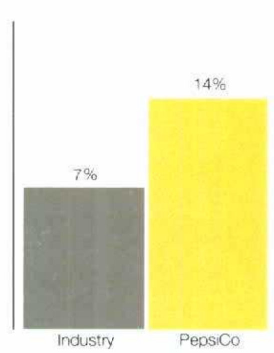
Fastest-Growing U.S. Restaurant Categories



(Compounded annual sales growth rate 1984-1989)

PepsiCo's restaurant categories–Mexican food, pizza and chicken–are among the four largest and fastest-growing quick service restaurant categories in the United States.

PepsiCo U.S. Restaurant Systems Sales Growth vs. U.S. Quick Service Industry Growth 1989



PepsiCo's U.S. restaurant systems grew 14% in 1989, compared to quick service restaurant industry growth of over 7%.

operating profits increased 17% primarily reflecting volume growth in traditional restaurant and delivery operations, partially offset by higher labor and food costs. The worldwide operating profit margin, excluding the Australian restaurant resales gain, was 7.6% in 1988, about even with 1987. Comparable sales for domestic company-owned units (including delivery) rose 9%. Excluding the impact of the Australian restaurant resales gain, international net sales and operating profits posted strong double-digit increases. This growth was primarily due to additional units and higher franchise royalty revenues.

Taco Bell's worldwide net sales grew 15% to $1.2 billion reflecting additional units and increased volume that occurred in the fourth quarter when a new value-oriented menu was introduced. Operating profits declined 11% to $82 million principally due to higher operating costs and lower gains on restaurant resales, partially offset by the impact of additional units and food cost controls. The worldwide operating profit margin declined two points to 7.1% in 1988. Comparable sales for domestic company-owned units were even with the prior year. International net sales improved and operating losses declined slightly.

KFC's worldwide net sales grew 12% to $1.2 billion, while operating profits improved 29% to $117 million. Excluding the $8.0 million reorganization charge in 1987, worldwide operating profits rose 19%. The worldwide operating profit margin, excluding the reorganization charge, rose one-half point to 9.6% in 1988. Domestic net sales growth was driven by price increases and additional units. Comparable sales for domestic company-owned units rose 5%. KFC's higher domestic operating profits, excluding the impact of the reorganization charge, were due to price increases, additional units and franchise royalty revenue growth that more than offset increased chicken and operating costs. Led by Australia and Canada, international net sales improved as a result of the favorable translation impact of the weaker U.S. dollar, an increase in distribution sales and increased prices. Strong international operating profit growth was driven by higher franchise royalty revenues and the favorable translation impact of the weaker U.S. dollar.

The combined units of Kentucky Fried Chicken, Pizza Hut and Taco Bell make PepsiCo the largest restaurant system in the world.

Contents

Business Segments

This information constitutes a Note to the Consolidated Financial Statements. (tabular dollars in millions)

PepsiCo operates on a worldwide basis within three distinct industry segments: soft drinks, snack foods and restaurants. Management's discussion and analysis of PepsiCo's industry segments is presented in the narratives beginning on pages 13, 21 and 29 under the caption "Management's Analysis."

The soft drinks segment primarily manufactures concentrates and markets Pepsi-Cola, Mountain Dew, Slice and their allied brands worldwide and 7UP internationally, and operates soft drink bottling businesses principally in the United States. The soft drinks segment data reflect a number of acquisitions of franchised domestic bottlers, the largest of which were the bottling businesses of General Cinema Corporation and Grand Metropolitan Incorporated acquired in 1989 and 1988, respectively.

The snack foods segment primarily manufactures and markets snack chips. The snack foods segment data reflect the 1989 acquisitions of Smiths Crisps Limited and Walkers Crisps Holdings Limited (Smiths and Walkers), which manufacture and market snack chips in the United Kingdom.

The restaurants segment data include the operations of Pizza Hut, Taco Bell and Kentucky Fried Chicken (KFC) and reflect the acquisitions of several franchised domestic and international restaurant operators, which were not significant in the aggregate. Restaurant net sales include net sales by company-operated restaurants, initial franchise fees, royalty and rental payments from restaurants operated by franchisees, gains on sales of restaurant businesses and net sales to franchisees by PepsiCo's restaurant distribution operation.

All acquisitions were accounted for under the purchase method, and accordingly the results of the acquired businesses are included from their respective dates of acquisition. (See Note to Consolidated Financial Statements on page 43.) The acquisition of Smiths and Walkers had a significant impact on PepsiCo's foreign operations, as reflected in the foreign data presented.

PepsiCo holds a number of equity interests of 50% or less that are reported under the equity method of accounting. Under generally accepted accounting principles, equity in the net income of these joint ventures is excluded from segment operating profits. The equity investments and related equity in net income are not material to the industry segment data. To improve comparability, 1988 and 1987 net sales and operating profits have been restated to report under the equity method of accounting certain previously consolidated KFC foreign joint ventures due to a reduction of PepsiCo's voting interest in early 1989. (See Note to Consolidated Financial Statements on page 43.)

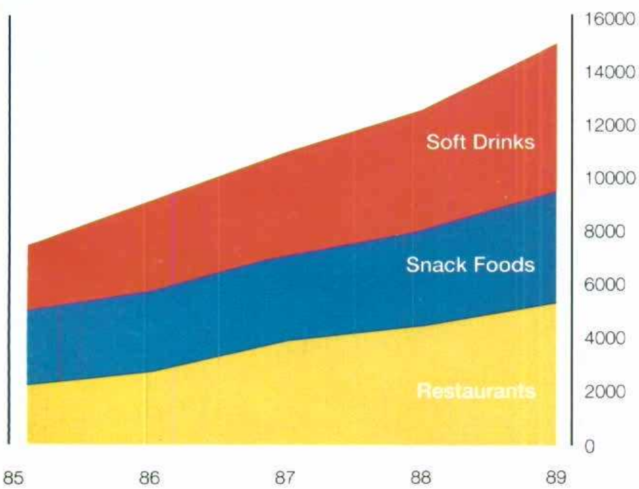
In determining geographic area data, the results of operations of PepsiCo's soft drink concentrate manufacturing facilities in Puerto Rico and Ireland have been allocated based upon actual concentrate sales to the respective geographic areas. Certain centralized foreign administrative expenses in each of the three industry segments have been allocated based upon sales volumes or number of restaurants in the respective geographic areas.

Net corporate expenses primarily consist of interest expense as well as corporate items and interest income that are not allocated to the business segments. Unallocated interest income was $141 million, $100 million and $87 million in 1989, 1988 and 1987, respectively. Net corporate expenses also included equity in net income of joint ventures of $13.4 million, $15.8 million and $19.5 million in 1989, 1988 and 1987, respectively. Because of a 1988 restatement of the 1987 Consolidated Statement of Income, the 1987 equity in net income of joint ventures reflects 100% of the net income of certain previously consolidated domestic soft drink bottling operations contributed to joint ventures in early 1988. The Consolidated Balance Sheet was not restated.

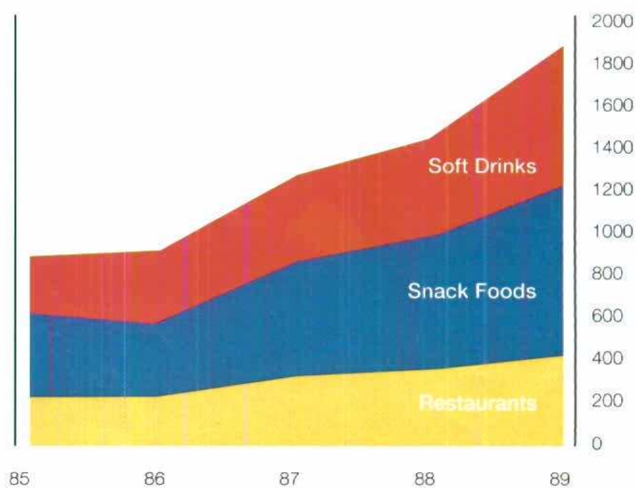
Corporate identifiable assets consist principally of offshore short-term investments and investments in joint ventures. PepsiCo's investments in joint ventures totaled $676 million, $500 million and $178 million at year-end 1989, 1988 and 1987, respectively, and consist principally of foreign businesses operating in all three of PepsiCo's industry segments and a 20% equity interest in a large domestic franchised bottler acquired in 1988.

1989 and 1987 consisted of 52 weeks, while 1988 consisted of 53 weeks.

Net Sales
($ In Millions)



Segment Operating Profits
($ In Millions)



Industry Segments:		Net Sales			Operating Profits[a]			Identifiable Assets[b]		
		1989	1988	1987	**1989**	1988	1987	**1989**	1988	1987
Soft Drinks:	U.S.	**$ 4,623.3**	$ 3,667.0	$ 3,112.9	**$ 586.9**	$ 409.5	$ 363.1			
	Foreign	**1,153.4**	971.2	862.7	**103.2**	53.4	46.5			
		5,776.7	4,638.2	3,975.6	**690.1**	462.9	409.6	**$ 6,241.9**	$ 4,074.4	$2,779.8
Snack Foods:	U.S.	**3,211.3**	2,933.3	2,782.8	**668.3**	587.3	520.0			
	Foreign	**1,003.7**	581.0	419.2	**152.6**	49.0	27.6			
		4,215.0	3,514.3	3,202.0	**820.9**	636.3	547.6	**3,366.4**	1,641.2	1,632.5
Restaurants:	U.S.	**4,684.8**	3,950.3	3,499.5	**361.8**	307.0	281.6			
	Foreign	**565.9**	430.4	341.0	**59.4**	44.4	37.8			
		5,250.7	4,380.7	3,840.5	**421.2**	351.4	319.4	**3,095.2**	3,105.1	2,782.9
Total:	U.S.	**12,519.4**	10,550.6	9,395.2	**1,617.0**	1,303.8	1,164.7			
	Foreign	**2,723.0**	1,982.6	1,622.9	**315.2**	146.8	111.9			
		$15,242.4	$12,533.2	$11,018.1	**$1,932.2**	$1,450.6	$1,276.6	**$12,703.5**	$ 8,820.7	$7,195.2
Geographic Areas:[(a), (b), (c)]										
United States		**$12,519.4**	$10,550.6	$ 9,395.2	**$1,617.0**	$1,303.8	$1,164.7	**$ 9,633.2**	$ 7,264.6	$5,699.4
Western Europe		**739.0**	390.8	308.0	**55.5**	13.0	6.7	**1,754.8**	187.7	169.1
Canada and Mexico		**899.0**	726.3	501.5	**126.3**	55.0	39.9	**460.6**	348.0	359.8
Other		**1,085.0**	865.5	813.4	**133.4**	78.8	65.3	**854.9**	1,020.4	966.9
								12,703.5	8,820.7	7,195.2
Corporate Assets[(c)]								**2,423.2**	2,314.6	1,827.5
Total		**$15,242.4**	$12,533.2	$11,018.1	**1,932.2**	1,450.6	1,276.6	**$15,126.7**	$11,135.3	$9,022.7
Interest and Other Corporate Expenses, Net					**(581.7)**	(323.4)	(331.0)			
Income from Continuing Operations Before Income Taxes					**$1,350.5**	$1,127.2	$ 945.6			

	Capital Spending			Depreciation and Amortization Expense		
	1989	1988	1987	**1989**	1988	1987
Soft Drinks	**$ 267.8**	$ 198.4	$ 202.0	**$306.3**	$195.7	$166.5
Snack Foods	**257.9**	172.6	195.6	**189.3**	156.8	154.1
Restaurants	**424.6**	344.2	370.8	**269.9**	271.3	237.1
Corporate	**9.2**	14.9	6.6	**6.5**	5.5	5.3
	$ 959.5	$ 730.1	$ 775.0	**$772.0**	$629.3	$563.0

Supplementary Restaurants Data:

	Net Sales			Operating Profits[a]		
Pizza Hut	**$2,453.5**	$2,014.2	$1,753.2	**$208.6**	$153.3	$138.0
Taco Bell	**1,465.9**	1,157.3	1,004.4	**112.6**	81.6	91.4
KFC	**1,331.3**	1,209.2	1,082.9	**100.0**	116.5	90.0
	$5,250.7	$4,380.7	$3,840.5	**$421.2**	$351.4	$319.4

(a) **Unusual items:** Results for the years presented were affected by several unusual credits and charges, the impacts of which were a net credit of $4.4 million ($1.8 after-tax or $0.01 per share) in 1989, a net charge of $23.9 million ($16.3 after-tax or $0.06 per share) in 1988 and a net credit of $19.8 million ($13.7 after-tax or $0.05 per share) in 1987. The unusual items in each industry segment were as follows:
Soft Drinks: 1989 included a $32.5 million credit resulting from a decision to retain a bottling operation in Japan previously held for sale and a $12.3 million reorganization charge to decentralize international operations. 1988 included a $14.5 million reorganization charge to decentralize domestic operations and a $9.4 million loss resulting from the sale of a Spanish winery. 1987 included a $10.3 million gain resulting from the sale of a bottling operation in Puerto Rico.
Snack Foods: 1989 included a $6.6 million reorganization charge to decentralize domestic operations and a $4.3 million credit resulting from a decision to retain a domestic cookie production facility previously held for sale. 1987 included a $10.0 million gain resulting from the sale of another domestic cookie production facility.
Restaurants: 1989 included an $8.0 million reorganization charge to consolidate domestic field operations of KFC and a $5.5 million reorganization charge to consolidate domestic operations of Taco Bell. 1987 included an $8.0 million reorganization charge to consolidate KFC's domestic operations and a $7.5 million gain resulting from the sale of certain Pizza Hut restaurants in Australia.

(b) The identifiable assets were not restated for the previously consolidated KFC foreign joint ventures now reported under the equity method.

(c) At year-end 1989 PepsiCo held an investment of $78 million in a Canadian snack food joint venture and a $122 million investment in the KFC Japan joint venture, which are included in corporate assets.

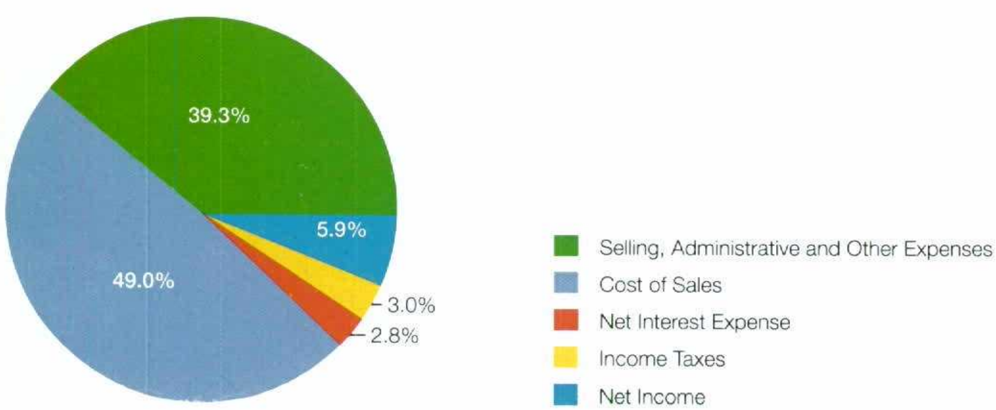
Consolidated Statement of Income

(in millions except per share amounts)
PepsiCo, Inc. and Subsidiaries
Fifty-two weeks ended December 30, 1989, fifty-three weeks ended December 31, 1988 and fifty-two weeks ended December 26, 1987

	1989	1988	1987
Net Sales	**$15,242.4**	$12,533.2	$11,018.1
Costs and Expenses			
Cost of sales	**7,467.7**	5,957.4	5,156.7
Selling, administrative and other expenses	**5,991.8**	5,226.6	4,733.8
Interest expense	**609.6**	344.2	294.6
Interest income	**(177.2)**	(122.2)	(112.6)
	13,891.9	11,406.0	10,072.5
Income from Continuing Operations Before Income Taxes	**1,350.5**	1,127.2	945.6
Provision for Income Taxes	**449.1**	365.0	340.5
Income from Continuing Operations	**901.4**	762.2	605.1
Discontinued Operations			
Loss from discontinued operations (net of income tax benefit of $1.3)	**–**	–	(1.3)
Loss on disposal (net of income tax benefit of $6.9)	**–**	–	(9.0)
	–	–	(10.3)
Net Income	**$ 901.4**	$ 762.2	$ 594.8
Income (Loss) Per Share			
Continuing operations	**$3.40**	$2.90	$2.30
Discontinued operations	**–**	–	(0.04)
Net Income Per Share	**$3.40**	$2.90	$2.26
Average shares outstanding used to calculate income (loss) per share	**265.3**	263.5	263.1

See accompanying Notes to Consolidated Financial Statements.

Allocation Of 1989 Net Sales



Management's Analysis—Results of Operations

The Consolidated Statement of Income for 1988 and 1987 has been restated to report under the equity method of accounting the results of certain previously consolidated foreign joint ventures of Kentucky Fried Chicken. This restatement had no effect on income from continuing operations or net income. (See Note to Consolidated Financial Statements on page 43.) The Consolidated Statement of Income for 1989 reflects the acquisitions of the franchised domestic soft drink bottling businesses of General Cinema Corporation (GC Beverage) and the Smiths and Walkers (S&W) snack food businesses in the United Kingdom. The comparisons of 1989 to 1988 results are also affected by the acquisitions of a number of franchised domestic bottlers principally in the second half of 1988, as well as the sale of certain domestic bottling operations in late 1988. Accordingly, the discussions of 1989 vs. 1988 are supplemented, where significant, with comparisons excluding the estimated impact of GC Beverage, S&W and the 1988 bottler acquisitions (net of divestitures), collectively referred to as "the Acquisitions." Comparisons excluding the impact of the Acquisitions are computed by excluding from 1989 both the results of the 1989 acquisitions and the results of the 1988 acquisitions for the corresponding periods the acquisitions were not reflected in 1988 results. Comparisons of results for the three years also were affected by one more week in the 1988 reporting period.

Net Sales, Costs and Expenses

Net sales rose 22% in 1989 and 14% in 1988. Excluding the impact of the Acquisitions, net sales increased 14% in 1989. The growth in both years was driven by volume gains in all three industry segments as well as additional restaurant and delivery units. Of the $1.7 billion growth in 1989 (excluding the impact of the Acquisitions), 50% was due to volume gains and almost 20% was attributable to additional units in the restaurants segment. The balance of the growth primarily reflected price increases. International net sales represented 18%, 16% and 15% of consolidated net sales in 1989, 1988 and 1987, respectively, primarily reflecting the S&W acquisition and strong growth in existing operations. Management's Analysis of the net sales and operating profit performances of each industry segment is presented in the narratives beginning on pages 13, 21 and 29.

Cost of sales as a percentage of net sales was 49.0%, 47.5% and 46.8% in 1989, 1988 and 1987, respectively. The 1989 increase principally reflects lower menu prices at Taco Bell, the acquisitions of traditionally lower gross margin bottling operations and the impact of S&W's lower gross margin that results from sales to distributors. The 1988 increase related primarily to domestic soft drinks, reflecting greater price discounting, higher costs and the impact of bottler acquisitions. During 1989 domestic snack foods experienced certain weather-related increases in commodity costs, particularly for potatoes and cooking oils. The effects of these cost increases were mitigated through temporary price increases and favorable product sales mix.

Selling, administrative and other expenses increased 15% in 1989 and 10% in 1988. The 1989 growth reflected the impact of the Acquisitions in terms of both additive operating expenses and higher amortization of goodwill and other intangibles. Total amortization of goodwill and other intangibles, a portion of which is deductible for U.S. income tax purposes, was $150 million ($129 million after-tax or $0.49 per share), $72 million ($62 million after-tax or $0.24 per share) and $57 million ($42 million after-tax or $0.16 per share) in 1989, 1988 and 1987, respectively. The increases in selling, administrative and other expenses in 1989 and 1988 also reflected higher sales volumes and increased promotional expenses, as well as additional restaurant and delivery units.

Interest expense rose 77% in 1989 compared to 17% in 1988. The increases were primarily due to higher average domestic borrowings to finance the Acquisitions and higher domestic interest rates. Excluding the Acquisitions, interest expense would have been about even with 1988.

Interest income increased 45% in 1989 compared to 9% in 1988. The increases were due to higher average balances of offshore short-term investment portfolios and higher interest rates.

Income from Continuing Operations Before Income Taxes

Income from continuing operations before income taxes increased 20% in 1989 compared to 19% in 1988. Excluding the Acquisitions the 1989 growth was 35%. The improvements reflected double-digit operating profit advances in all three industry segments, with accelerating growth in 1989. The soft drinks and snack foods segments posted particularly strong operating profit margin improvements in 1989. Volume growth accounted for almost 85% of the $399 million increase in 1989 combined segment operating profits (excluding the impact of the Acquisitions), with the balance primarily representing additional restaurant units. Price increases were essentially offset by higher commodity costs and operating expenses. International operating profits represented 16%, 10% and 9% of combined segment operating profits in 1989, 1988 and 1987, respectively, primarily reflecting strong volume growth and the S&W acquisition.

Provision for Income Taxes

The effective tax rates on income from continuing operations were 33.3%, 32.4% and 36.0% in 1989, 1988 and 1987, respectively. The 1989 increase was primarily due to the growth in nondeductible goodwill and other intangibles amortization expense. The decrease in the 1988 effective tax rate from 1987 principally reflected the lower federal statutory tax rate provided by the U.S. Tax Reform Act of 1986.

In December 1989 the Financial Accounting Standards Board amended recently issued rules for accounting for income taxes to extend the required adoption date until 1992. (See Note to Consolidated Financial Statements on page 46.)

Income Per Share from Continuing Operations

Income per share from continuing operations increased 17% to $3.40 in 1989 compared to a 26% increase in 1988 to $2.90. The favorable effect of unusual items ($0.01 net credit in 1989 vs. $0.06 in charges in 1988) on the 1989 growth in net income per share was offset by the estimated unfavorable impact of one more week in 1988 ($0.06). Results in 1989 included an estimated $0.44 per share in dilution related to the Acquisitions. Results in 1988 included an estimated $0.09 in dilution from 1988 acquisitions. Reported dilution represents the results of acquisitions, including amortization of goodwill and other intangibles and estimated financing costs, through the first year subsequent to acquisition. First-year dilution in 1990 related to 1989 acquisitions is expected to approximate $0.14.

Consolidated Balance Sheet

(in millions except per share amount)
PepsiCo, Inc. and Subsidiaries
December 30, 1989 and December 31, 1988

	1989	1988
ASSETS		
Current Assets		
Cash and cash equivalents	$ 76.2	$ 142.7
Short-term investments, at cost which approximates market	1,457.7	1,475.1
	1,533.9	1,617.8
Notes and accounts receivable, less allowance: $57.7 in 1989 and $55.7 in 1988	1,239.7	979.3
Inventories	546.1	442.4
Prepaid expenses, taxes and other current assets	231.1	225.2
Total Current Assets	3,550.8	3,264.7
Investments, Long-term Receivables and Other Assets	970.8	825.7
Property, Plant and Equipment, net	5,130.2	4,462.5
Goodwill and Other Intangibles, net	5,474.9	2,582.4
Total Assets	$15,126.7	$11,135.3
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Short-term borrowings	$ 866.3	$ 1,451.0
Accounts payable	1,054.5	881.4
Income taxes payable	313.7	250.2
Other current liabilities	1,457.3	1,291.0
Total Current Liabilities	3,691.8	3,873.6
Long-term Debt	5,777.1	2,356.6
Nonrecourse Obligation	299.4	299.4
Other Liabilities and Deferred Credits	610.4	643.8
Deferred Income Taxes	856.9	800.9
Shareholders' Equity		
Capital stock, par value 1 2/3¢ per share: authorized 600.0 shares, issued 287.7 shares	4.8	4.8
Capital in excess of par value	333.5	312.2
Retained earnings	3,978.4	3,329.7
Cumulative translation adjustment	66.2	24.0
	4,382.9	3,670.7
Less: Treasury stock, at cost: 24.0 shares in 1989, 24.9 shares in 1988	(491.8)	(509.7)
Total Shareholders' Equity	3,891.1	3,161.0
Total Liabilities and Shareholders' Equity	$15,126.7	$11,135.3

See accompanying Notes to Consolidated Financial Statements.

Management's Analysis—Financial Condition

PepsiCo's overriding objective is to increase the value of its shareholders' investment through integrated operating, investing and financing strategies that maximize cash returns on investments and minimize the cost of capital. PepsiCo estimates its current cost of capital to be approximately 11%. The company believes the substantial increase in financial leverage associated with 1989 and 1988 acquisition activity has not significantly affected its cost of capital.

Assets

Total assets increased $4.0 billion or 36% over 1988. This increase reflects acquisitions that complement PepsiCo's existing businesses, principally in domestic soft drinks and international snack foods, as well as purchases of property, plant and equipment.

Substantially all of PepsiCo's short-term investments consist of marketable securities portfolios held offshore. The investments are high grade and subject to prudent investment policy guidelines. The investments have grown with the strong operating cash flows generated by soft drink concentrate manufacturing facilities in Puerto Rico and Ireland, which operate under tax incentives, as well as cash flows generated by other foreign operations. Tax-advantaged portfolios in Puerto Rico represent a substantial portion of the offshore investments. These funds may be remitted to the United States under the conditions provided by the recently amended tax incentive grant. (See Note to Consolidated Financial Statements on page 46.) PepsiCo continually reassesses its alternatives to redeploy these and other offshore portfolios, considering other investment opportunities, tax consequences and overall financing strategies. In 1989 certain offshore portfolios were liquidated to finance $331 million of the purchase price of the Smiths and Walkers businesses.

Investments, long-term receivables and other assets increased $145 million in 1989. This change primarily reflects the investment in the Japan joint venture of Kentucky Fried Chicken (KFC), which was previously included in PepsiCo's financial statements on a consolidated basis prior to a 1989 reduction in voting interest. (See Note to Consolidated Financial Statements on page 43.)

PepsiCo's purchases of property, plant and equipment totaled $960 million and $730 million in 1989 and 1988, respectively, led in both years by investments in the restaurants segment. Spending increases in 1989 reflected new unit development at Pizza Hut and KFC, manufacturing capacity and productivity enhancement projects in domestic and international snack foods, and investments in vending equipment in domestic soft drinks.

Goodwill and other intangibles increased $2.9 billion in 1989, principally reflecting the value of Pepsi-Cola franchise rights associated with the domestic franchised bottling businesses acquired from General Cinema Corporation (GC Beverage) and the value of the Smiths and Walkers snack foods brands. (See Note to Consolidated Financial Statements on page 43.)

Liabilities

Total liabilities rose $3.3 billion or 41% over 1988, due principally to increased debt to finance the 1989 acquisitions. The acquisitions were initially funded primarily through short-term borrowings. As part of its management of interest rate exposure, PepsiCo has entered into interest rate swap agreements to effectively fix the interest rates on portions of its commercial paper borrowings. (See Note to Consolidated Financial Statements on page 45.)

At year-end 1989, $3.6 billion of short-term borrowings were classified as long-term, reflecting PepsiCo's intent and ability to refinance these borrowings on a long-term basis, through either long-term debt issuances or rollover of existing short-term borrowings. The significant amount of short-term borrowings classified as long-term, as compared to year-end 1988 when no such amounts were reclassified, primarily reflects the large commercial paper issuances in 1989, but also resulted from a refined analysis of amounts expected to be refinanced beyond one year.

Financial Leverage

In managing its capital structure, PepsiCo utilizes financial leverage to minimize the overall cost of capital and increase returns to shareholders, while maintaining operating and financial flexibility.

PepsiCo measures leverage on a net basis, which takes into account its large offshore short-term investment portfolios. These portfolios are managed as part of the company's overall financing strategy and are not required to support day-to-day operations. Therefore, PepsiCo believes its net debt position, which reflects the pro forma remittance of the portfolios, net of related taxes, as a reduction of total debt (excluding the nonrecourse obligation) is the most meaningful measure of financial leverage used in the business. PepsiCo's ratio of net debt to net capital employed (defined as net debt, other liabilities and deferred credits, deferred income taxes and shareholders' equity) rose to approximately 51% at year-end 1989 from approximately 37% at year-end 1988. This increase reflects the additional debt required to finance the 1989 acquisitions. Because of the company's strong cash generating capability, PepsiCo believes it can safely exceed its long-term net debt target ratio of approximately 40%, and will do so when attractive investment opportunities such as GC Beverage and Smiths and Walkers arise. The company does not believe that the current leverage level significantly affects its overall cost of capital or reduces its ability to invest in the business.

PepsiCo's negative operating working capital position, which principally reflects the cash sales nature of its restaurant operations, is an interest-free source of capital. Operating working capital, which excludes short-term investments and short-term borrowings, was a negative $732 million and $633 million at year-end 1989 and 1988, respectively.

Shareholders' Equity

Return on average shareholders' equity represents a combination of operating performance and the effect of financial leverage. Based on net income, PepsiCo's return on average shareholders' equity was 25.6% in 1989 compared to 26.9% in 1988. The decrease reflects the dilutive earnings effect of the significant acquisitions in 1989 and 1988.

Consolidated Statement of Cash Flows

(in millions)
PepsiCo, Inc. and Subsidiaries
Fifty-two weeks ended December 30, 1989, fifty-three weeks ended December 31, 1988 and fifty-two weeks ended December 26, 1987

	1989	1988	1987
Cash Flows from Continuing Operations:			
Income from continuing operations	$ 901.4	$ 762.2	$ 605.1
Adjustments to reconcile income from continuing operations to net cash generated by continuing operations:			
Depreciation and amortization	772.0	629.3	563.0
Deferred income taxes	71.2	20.1	59.0
Other noncash charges and credits–net	128.4	213.4	105.4
Changes in operating working capital:			
Notes and accounts receivable	(149.9)	(50.1)	(95.6)
Inventories	(50.1)	13.8	4.1
Prepaid expenses, taxes and other current assets	6.5	37.8	39.7
Accounts payable	134.9	138.2	(76.9)
Income taxes payable	80.9	55.1	23.3
Other current liabilities	(9.4)	74.7	107.4
Net change in operating working capital	12.9	269.5	2.0
Net Cash Generated by Continuing Operations	1,885.9	1,894.5	1,334.5
Cash Flows from Investing Activities:			
Acquisitions and equity investments	(3,296.6)	(1,415.5)	(371.5)
Purchases of property, plant and equipment	(943.8)	(725.8)	(770.5)
Proceeds from sales of property, plant and equipment	69.7	67.4	98.6
Proceeds from sales of businesses	–	283.2	161.6
Other short-term investments–by original maturity:			
Three months or less–net	667.0	(411.1)	(736.1)
More than three months–purchases	(2,131.1)	(692.6)	(1,311.8)
More than three months–sales	1,476.4	902.0	1,526.2
Other, net	(97.9)	(58.7)	(72.9)
Net Cash Used for Investing Activities	(4,256.3)	(2,051.1)	(1,476.4)
Cash Flows from Financing Activities:			
Proceeds from issuances of long-term debt	71.7	475.3	598.3
Payments of long-term debt	(405.4)	(190.0)	(113.4)
Short-term borrowings–by original maturity:			
Three months or less–net	2,292.2	306.7	114.7
More than three months–proceeds	1,109.5	292.0	547.9
More than three months–payments	(476.2)	(367.4)	(1,157.0)
Proceeds from nonrecourse obligation	–	0.1	299.3
Cash dividends paid	(241.9)	(199.0)	(172.0)
Purchases of treasury stock	–	(71.8)	(18.6)
Other, net	(28.9)	(24.5)	(38.8)
Net Cash Generated by Financing Activities	2,321.0	221.4	60.4
Effect of Exchange Rate Changes on Cash and Cash Equivalents	(17.1)	(1.4)	(8.0)
Net Increase (Decrease) in Cash and Cash Equivalents	(66.5)	63.4	(89.5)
Cash and Cash Equivalents–Beginning of Year	142.7	79.3	168.8
Cash and Cash Equivalents–End of Year	$ 76.2	$ 142.7	$ 79.3

See accompanying Notes to Consolidated Financial Statements, including "Supplemental Cash Flow Information" on page 47.

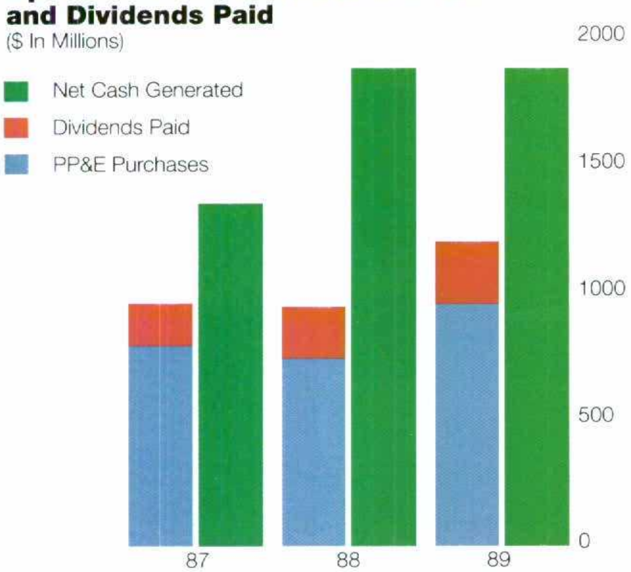
Management's Analysis—Cash Flows

Cash flow activity in 1989 reflected continuing strong cash flows from PepsiCo's existing operations ($1.9 billion). Together with net proceeds from issuances of debt ($2.6 billion), these cash flows funded acquisitions ($3.3 billion), purchases of property, plant and equipment ($944 million) and dividends ($242 million). Fluctuations in maturity categories of short-term investments and short-term borrowings primarily reflected ongoing strategies to diversify portfolios and manage interest rate exposure.

Net Cash Generated by Continuing Operations

One of PepsiCo's most significant financial strengths is its internal cash generation capability. In fact, in 1989 and 1988 both the domestic and international operations in each industry segment generated funds in excess of their property, plant and equipment (PP&E) purchases and working capital needs (before funding of acquisitions and equity investments). As the chart below illustrates, in each of the past three years, net cash generated by continuing operations has been well in excess of amounts required to fund purchases of PP&E and dividend payments.

Net Cash Generated by Continuing Operations vs. Purchases of PP&E and Dividends Paid
($ In Millions)



Net cash generated by continuing operations in 1989 was about even with 1988, compared to an increase in 1988 of $560 million or 42% over 1987. The 1989 decrease of $257 million in cash flows associated with operating working capital reflected additional investment required to support sales growth in the comparatively more working capital intensive bottling and snack foods businesses acquired. The decrease also reflected higher accounts receivable and inventories resulting from normal sales growth, and payments of prior year accruals. The 1988 improvement in operating working capital changes over 1987 was due primarily to a depressed accounts payable balance at year-end 1987. Growth in 1989 operating cash flows was negatively affected by approximately $175 million (after-tax) in increased interest expense associated with the financing of recent acquisitions. The increase of $143 million and $66 million in depreciation and amortization noncash charges in 1989 and 1988, respectively, reflected amortization of goodwill and other intangibles as well as depreciation expense associated with those acquisitions.

Investing Activities

PepsiCo's investing activities over the past three years reflected strategic spending in all three industry segments through investments in acquisitions, PP&E and joint ventures. Acquisitions for cash in 1989 totaled $3.3 billion and included the franchised domestic bottling operations of General Cinema Corporation and several other franchised soft drink bottlers, the Smiths and Walkers snack foods businesses in the United Kingdom and several small franchised restaurant operators. Noncash activity related to acquisitions and purchases of PP&E is presented in the Note to the Consolidated Financial Statements on page 47. Purchases of PP&E (cash and noncash) are expected to increase from $960 million in 1989 to approximately $1.1 billion in 1990. About 40% of that amount is targeted for the restaurants segment, with the balance evenly divided between the soft drinks and snack foods segments. The increase in planned PP&E spending reflects strategies to expand international snack food capacity, increase soft drink vending presence worldwide and expand domestic pizza delivery operations. PepsiCo continues to seek opportunities to strengthen its position in its domestic and foreign industry segments through strategic acquisitions.

Financing Activities

Financing activities increased $2.1 billion over 1988 reflecting the debt issuances required to finance the 1989 acquisitions. The acquisitions were initially funded primarily through short-term borrowings. Long-term refinancing of these borrowings has been integrated into PepsiCo's overall financing strategies and activities.

In April 1989 PepsiCo filed a shelf registration statement with the Securities and Exchange Commission covering up to $1.0 billion of potential debt issuances; $100 million of debt has been issued under the shelf registration as of year-end 1989.

Cash dividends declared were a record $253 million in 1989 and $209 million in 1988. PepsiCo targets a dividend payout of approximately one-third of the prior year's earnings, thus retaining sufficient earnings to enhance productive capability and provide adequate financial resources for growth opportunities.

In 1987 PepsiCo's Board of Directors authorized the repurchase from time to time of up to 15 million shares of PepsiCo Capital Stock. Share repurchase decisions are evaluated considering the target capital structure and other investment opportunities. Repurchase activity over the last three years has not been significant.

PepsiCo's unused credit facilities, which exist largely to support the issuances of short-term borrowings, were increased to $3.6 billion from $1.2 billion at year-end 1988. These additional facilities were required to support the financing of the 1989 acquisitions. PepsiCo's strong financial condition provides continued access to capital markets throughout the world.

Consolidated Statement of Shareholders' Equity

(shares in thousands, dollars in millions, except per share amounts)
PepsiCo, Inc. and Subsidiaries
Fifty-two weeks ended December 30, 1989, fifty-three weeks ended December 31, 1988 and fifty-two weeks ended December 26, 1987

	Capital Stock				Capital		Cumulative	
	Issued		Treasury		in Excess	Retained	Translation	
	Shares	Amount	Shares	Amount	of Par Value	Earnings	Adjustment	Total
Shareholders' Equity, December 27, 1986	287,694	$ 4.8	(27,375)	$(549.3)	$287.0	$2,356.6	$(40.0)	$2,059.1
1987 Net income						594.8		594.8
Cash dividends declared (per share–$0.67)						(174.7)		(174.7)
Shares reissued to Payroll-Based Employees Stock Ownership Plan			139	2.7	2.6			5.3
Payment of compensation awards and exercise of stock options			332	6.7	2.7			9.4
Conversion of debentures			244	4.9	(1.8)			3.1
Translation adjustments							30.2	30.2
Purchase of treasury stock			(621)	(18.6)				(18.6)
Shareholders' Equity, December 26, 1987	287,694	$ 4.8	(27,281)	$(553.6)	$290.5	$2,776.7	$ (9.8)	$2,508.6
1988 Net income						762.2		762.2
Cash dividends declared (per share–$0.80)						(209.2)		(209.2)
Shares reissued to Employee Stock Ownership Plan			122	2.5	1.6			4.1
Payment of compensation awards and exercise of stock options			324	6.6	0.5			7.1
Conversion of debentures			1,015	20.7	(2.6)			18.1
Translation adjustments							33.8	33.8
Purchase of treasury stock			(2,066)	(71.8)				(71.8)
Shares issued in connection with acquisitions			3,003	85.9	22.2			108.1
Shareholders' Equity, December 31, 1988	287,694	$ 4.8	(24,883)	$(509.7)	$312.2	$3,329.7	$ 24.0	$3,161.0
1989 Net income						**901.4**		**901.4**
Cash dividends declared (per share–$0.96)						**(252.7)**		**(252.7)**
Payment of compensation awards and exercise of stock options			**300**	**6.2**	**2.6**			**8.8**
Conversion of debentures			**152**	**3.1**	**0.8**			**3.9**
Translation adjustments							**42.2**	**42.2**
Shares issued in connection with an acquisition			**422**	**8.6**	**17.9**			**26.5**
Shareholders' Equity, December 30, 1989	**287,694**	**$ 4.8**	**(24,009)**	**$(491.8)**	**$333.5**	**$3,978.4**	**$ 66.2**	**$3,891.1**

See accompanying Notes to Consolidated Financial Statements.

(tabular dollars in millions except per share amounts)

Summary of Significant Accounting Policies

Principles of Consolidation. The financial statements reflect the consolidated accounts of PepsiCo, Inc. and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. Equity interests of 50% or less in joint ventures in which PepsiCo exercises significant influence are accounted for by the equity method, and the equity in net income is included in the Consolidated Statement of Income under the caption "Selling, administrative and other expenses." The Consolidated Statement of Income for 1988 and 1987 has been restated to report under the equity method of accounting the results of certain previously consolidated foreign joint ventures of Kentucky Fried Chicken (KFC). The restatement resulted principally from a reduction of PepsiCo's voting interest to less than 50% in the KFC joint venture in Japan, which was the largest of these joint ventures. A portion of PepsiCo's voting stock was sold to the joint venture's directors and certain employees in early 1989. Although the equity interests and previously consolidated operations were not significant to the Consolidated Financial Statements of PepsiCo, the restatement is intended to improve comparability of PepsiCo's operating results. The restatement had no effect on income from continuing operations or net income. The Consolidated Balance Sheet and Statement of Cash Flows were not restated.

Goodwill and Other Intangibles. Goodwill and other intangibles arose from the allocation of purchase prices of businesses acquired, with the largest portion representing the value of Pepsi-Cola franchise rights related to the acquisitions of franchised domestic soft drink bottling operations. Goodwill and other intangibles are amortized on a straight-line basis over appropriate periods not exceeding 40 years. Amortization expense included in the Consolidated Statement of Income under the caption "Selling, administrative and other expenses" in 1989, 1988 and 1987 was $150 million, $72 million and $57 million, respectively. Accumulated amortization was $359 million and $209 million at year-end 1989 and 1988, respectively.

Marketing Costs. Marketing costs are included in the Consolidated Statement of Income under the caption "Selling, administrative and other expenses." Costs of materials in inventory and prepayments are deferred, and certain promotional discounts are expensed as incurred. All other costs of advertising and other marketing and promotional programs are charged to expense ratably over the year in which incurred, generally in relation to sales.

Classification of Restaurant Operating Expenses. Operating expenses incurred at the restaurant and delivery store level consist primarily of food and related packaging costs, labor associated with food preparation and customer service, and overhead expenses. For purposes of the Consolidated Statement of Income, food and packaging costs as well as all labor-related expenses are classified as "Cost of sales," and all other store level expenses are classified as "Selling, administrative and other expenses."

Cash Equivalents. Cash equivalents are comprised of funds temporarily invested (with original maturities not exceeding three months) as part of PepsiCo's management of day-to-day operating cash receipts and disbursements. All other investment portfolios, primarily held offshore, are classified as short-term investments.

Net Income Per Share. Net income per share is computed by dividing net income by the weighted average number of shares and share equivalents outstanding during each year.

Research and Development Expenses. Research and development expenses, which are expensed as incurred, were $91 million, $84 million and $83 million in 1989, 1988 and 1987, respectively.

Business Segments

Information regarding industry segments and geographic areas of operations is provided on pages 34 and 35.

Acquisitions and Equity Investments

During 1989 PepsiCo completed a number of acquisitions with purchase prices aggregating $3.4 billion, principally for cash. The acquisitions included the franchised domestic soft drink bottling operations of General Cinema Corporation (GC Beverage), acquired on March 23, 1989 for $1.77 billion, and Smiths Crisps Limited and Walkers Crisps Holdings Limited (Smiths and Walkers), two snack foods companies in the United Kingdom, acquired on July 1, 1989 for $1.34 billion. The remaining activity consisted primarily of acquisitions of franchised domestic soft drink bottlers and restaurant operators.

Acquisition and equity investment activity in 1988 aggregated $1.8 billion, principally comprised of over $1.4 billion in cash, $220 million in notes and $108 million in PepsiCo Capital Stock. The majority of these acquisitions were franchised domestic soft drink bottlers, the largest of which were the bottling operations of Grand Metropolitan Incorporated acquired on August 4, 1988 for $705 million in cash. On December 31, 1987 PepsiCo also acquired a 20% equity investment in Pepsi-Cola General Bottlers, Inc. (the remaining equity of which is owned by Whitman Corporation), contributing $177 million in cash and certain previously consolidated bottling operations with an aggregate carrying value of $17 million.

The acquisitions have been accounted for by the purchase method; accordingly, their results are included in the Consolidated Financial Statements from their respective dates of acquisition. The 1989 purchase prices have been preliminarily allocated to the estimated fair value of the assets acquired and liabilities assumed. Goodwill and other intangibles recorded in connection with the 1989 acquisitions totaled $3.0 billion.

The following table presents the unaudited pro forma combined results of PepsiCo and the 1989 acquisitions of GC Beverage and Smiths and Walkers as if they had occurred at the beginning of 1989 and 1988, and a substantial majority of the 1988 acquisitions as if they had occurred at the beginning of 1988 and 1987. The aggregate impact of other acquisitions in the periods presented was not material to PepsiCo's net sales, income or income per share; accordingly, no related pro forma information is provided. The pro forma information does not necessarily represent what the actual consolidated results would have been for these periods and is not intended to be indicative of future results.

	1989	1988	1987
Net sales	$15,620.2	$13,930.9	$11,450.0
Income from continuing operations	$ 859.3	$ 649.3	$ 569.0
Per share	$ 3.24	$ 2.47	$ 2.17
Net income	$ 859.3	$ 649.3	$ 558.7
Per share	$ 3.24	$ 2.47	$ 2.13

Discontinued Operations

In 1987 PepsiCo sold La Petite Boulangerie, Inc. (LPB), a retail bakery operation, for $15 million in cash. The sale produced a loss of $16 million before-tax and $9 million after-tax ($0.03 per share). The 1987 loss on the sale of LPB is reflected in the Consolidated Statement of Income under the caption "Loss on disposal." The results of the operations of LPB, through the date of sale, are included in the Consolidated Statement of Income under the caption "Loss from discontinued operations." LPB's 1987 net sales were $15 million through the date of sale.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation is calculated principally on a straight-line basis over the estimated useful lives of the assets. Depreciation and amortization expense in 1989, 1988 and 1987 was $610 million, $547 million and $501 million, respectively. Interest capitalized as an additional cost of property, plant and equipment was $3 million, $2 million and $5 million in 1989, 1988 and 1987, respectively.

	1989	1988
Land	$ 702.0	$ 568.9
Buildings and improvements	2,815.6	2,557.0
Capital leases, primarily buildings	241.9	206.6
Machinery and equipment	4,058.9	3,325.9
	7,818.4	6,658.4
Accumulated depreciation and amortization	(2,688.2)	(2,195.9)
	$5,130.2	$4,462.5

Inventories

Inventories are valued at the lower of cost (computed on the average, first-in, first-out or last-in, first-out methods) or net realizable value. Inventories computed on the last-in, first-out (LIFO) method comprised 56% of inventories at both year-end 1989 and 1988.

	1989	1988
Raw materials, supplies and in-process	$295.1	$237.6
Finished goods	266.5	220.0
Total (approximates current cost)	561.6	457.6
Excess of current cost over LIFO cost	(15.5)	(15.2)
	$546.1	$442.4

Leases

PepsiCo has noncancelable commitments under both capital and operating leases, primarily for restaurant units. Certain of these units have been subleased to restaurant franchisees. Lease commitments on capital and operating leases expire at various dates through 2032.

Future minimum lease commitments and sublease receivables under noncancelable leases are as follows:

	Commitments		Sublease Receivables	
	Capital	Operating	Direct Financing	Operating
1990	$ 37.4	$ 148.4	$ 8.6	$ 9.8
1991	33.3	132.7	8.5	9.2
1992	29.7	120.9	8.0	8.8
1993	27.5	110.9	6.8	8.4
1994	26.3	98.4	6.7	8.0
Later years	120.9	507.2	23.0	45.5
	$275.1	$1,118.5	$61.6	$89.7

At year-end 1989 the present value of minimum lease payments for capital leases was $179 million, after deducting $1 million for estimated executory costs (taxes, maintenance and insurance) and $95 million representing imputed interest. The present value of minimum sublease receivables was $38 million after deducting $24 million of unearned interest income.

Rental expense and income were as follows:

	Rental	
	Expense	Income
1989	$236.9	$14.2
1988	219.7	13.2
1987	187.6	16.6

Included in the above amounts were contingent rental expense of $20.8 million, $16.8 million and $19.7 million and contingent rental income of $4.5 million, $4.6 million and $5.8 million in 1989, 1988 and 1987, respectively. Contingent rentals are based on sales by restaurants in excess of stipulated levels as provided in lease agreements.

Short-term Borrowings and Long-term Debt

	1989	1988
Short-term Borrowings		
Commercial paper (**A**)	**$3,081.8**	$ 757.9
Notes (**B**)	**594.8**	–
Current maturities of long-term debt issuances	**316.8**	355.8
Other borrowings	**422.9**	337.3
Amount reclassified to long-term debt (**C**)	**(3,550.0)**	–
	$ 866.3	$1,451.0

	1989	1988
Long-term Debt		
Short-term borrowings, reclassified (**C**)	**$3,550.0**	$ –
Notes due 1990 through 1998 (7.9% weighted average interest rate at year-end 1989 and 1988) (**B**)	**871.1**	1,078.2
Zero coupon notes, $1.1 billion due 1990-2012 (14.0% semi-annual weighted average yield to maturity at year-end 1989 and 1988)	**308.7**	274.4
European Currency Units 7⅝% and 7⅜% notes due 1990 and 1992 (**D**)	**239.3**	234.4
Swiss franc perpetual Foreign Interest Payment bonds (**E**)	**209.1**	208.3
Pound sterling 9⅛% notes due 1993 (**D**)	**96.8**	108.5
Swiss franc 5¼% bearer bonds due 1995 (**D**)	**86.9**	87.2
Australian dollar notes due 1990 (13.3% and 13.6% weighted average interest rate at year-end 1989 and 1988, respectively) (**D**)	**81.5**	148.6
Italian lire 10½% notes due 1991 (**D**)	**79.0**	76.4
Canadian dollar 8¾% notes due 1991 (**B**)	**64.6**	62.6
New Zealand dollar 18½% notes due 1989 (**D**)	**–**	37.8
Capital lease obligations (See Note on page 44.)	**179.3**	144.2
Other, due 1990-2014 (9.0% and 8.5% weighted average interest rate at year-end 1989 and 1988, respectively)	**327.6**	251.8
	6,093.9	2,712.4
Less current maturities of long-term debt issuances	**316.8**	355.8
Total long-term debt	**$5,777.1**	$2,356.6

Long-term debt is carried net of any related discount or premium and unamortized debt issuance costs. Foreign currency denominated debt has been valued at year-end exchange rates. The debt agreements include various restrictions, none of which is presently significant to PepsiCo.

The annual maturities of long-term debt through 1994, excluding capital lease obligations and the reclassified short-term borrowings are: 1990–$299 million; 1991–$396 million; 1992–$231 million; 1993–$598 million and 1994–$101 million.

(**A**) In 1989 PepsiCo entered into interest rate swap agreements to effectively fix the interest rate on $2.5 billion of commercial paper borrowings for periods of three to twelve months from the date of the swaps. Of this amount $1.5 billion was outstanding at year-end 1989. At year-end 1989, the weighted average interest rate on $3.1 billion of commercial paper borrowings was 8.7%, including the effect of the swaps.

(**B**) PepsiCo has entered into interest rate swap agreements to effectively convert $1.2 billion of fixed interest rate debt issuances to variable rate debt with a weighted average interest rate of 8.3% at year-end 1989, as well as effectively convert a $100 million variable interest rate debt issuance to fixed rate debt with an interest rate of 9.8%.

(**C**) At year-end 1989 $3.6 billion of short-term borrowings were classified as long-term, reflecting PepsiCo's intent and ability to refinance these borrowings on a long-term basis, through either long-term debt issuances or rollover of existing short-term borrowings. The significant amount of short-term borrowings classified as long-term, as compared to year-end 1988 when no such amounts were reclassified, primarily reflects the large commercial paper issuances in 1989, but also resulted from a refined analysis of amounts expected to be refinanced beyond one year. At year-end 1989 and 1988 PepsiCo had revolving credit agreements aggregating $3.6 billion and $1.2 billion, respectively, with the current agreements covering potential borrowings through 1994. These unused credit facilities provide the ability to refinance short-term borrowings.

(**D**) PepsiCo has entered into currency exchange agreements to hedge its foreign currency exposure on these issues of non-U.S. dollar denominated debt. At year-end 1989, the agreements effectively established U.S. dollar liabilities of $160 million with a weighted average fixed interest rate of 8.7% and $365 million with a weighted average variable interest rate of 8.1%.

(**E**) The coupon rate of the Swiss franc 400 million perpetual Foreign Interest Payment bonds issued in 1986 is 7½% through 1996. The interest payments are made in U.S. dollars at a fixed contractual exchange rate. The bonds have no stated maturity date. At the end of each 10-year period after the issuance of the bonds, PepsiCo and the bondholders each have the right to cause redemption of the bonds. If not redeemed, the coupon rate will be adjusted based on the prevailing yield of 10-year U.S. Treasury Securities. The principal of the bonds is denominated in Swiss francs. PepsiCo can and intends to limit the ultimate redemption amount to the U.S. dollar proceeds at issuance, which is the basis of the carrying value in both years.

Nonrecourse Obligation

In 1987 PepsiCo entered into an agreement related to a nonrecourse obligation (the Obligation) under which it received net proceeds of $299 million. The Obligation and related interest are payable solely from future royalty payments from certain independent domestic franchisees of one of PepsiCo's restaurant systems, for a period not to exceed 10 years. The Obligation carries a variable interest rate (8.6% as of December 30, 1989) based upon a commercial paper rate. Under the amended terms of the agreement, principal repayments during the first five years can be readvanced; as it is PepsiCo's intent to elect this provision, the entire Obligation is considered noncurrent. Principal repayments, net of amounts readvanced, are estimated to be $174 million over the next five years.

Income Taxes

Provision for income taxes on income from continuing operations:

		1989	1988	1987
Current	– Federal	**$221.7**	$235.2	$226.8
	Foreign	**89.5**	52.8	19.0
	State	**38.0**	40.6	22.5
		349.2	328.6	268.3
Deferred	– Federal	**95.7**	37.4	32.9
	Foreign	**1.2**	1.7	(2.2)
	State	**3.0**	(2.7)	41.5
		99.9	36.4	72.2
		$449.1	$365.0	$340.5

The deferred income tax provision, which results from differences in the timing of recognition of revenue and expense for financial reporting and tax purposes, included amounts related to depreciation of property, plant and equipment of $36.3 million, $44.0 million and $66.5 million and amortization of intangibles of $47.3 million, $15.6 million and $8.8 million in 1989, 1988 and 1987, respectively.

U.S. and foreign income from continuing operations before income taxes:

	1989	1988	1987
U.S.	**$ 843.4**	$ 773.4	$605.6
Foreign	**507.1**	353.8	340.0
	$1,350.5	$1,127.2	$945.6

Consistent with the allocation for tax purposes, approximately 50% of the income arising from the sale of soft drink concentrates manufactured in Puerto Rico is included in Foreign in the above table. In 1989 the tax incentive grant under which PepsiCo's soft drink concentrate manufacturing facilities in Puerto Rico operate was amended. Under the terms of the amended grant that expires in 2006, the previously untaxed earnings of approximately $1 billion held in Puerto Rico as of December 31, 1988 may be remitted to the United States at PepsiCo's option over the subsequent three-year period or later for a nominal tax. Further under the amended grant, earnings in Puerto Rico subsequent to 1988, whether or not remitted, are subject to a tax of approximately 4% in 1989 and 7% in 1990 and beyond. PepsiCo's soft drink concentrate manufacturing profits in Ireland were exempt from income tax through mid-1989 when a 10% tax became effective. The increased taxes related to the Puerto Rico and Ireland concentrate manufacturing facilities are not expected to materially impact PepsiCo's consolidated net income or cash flows.

Deferred taxes were not provided on unremitted earnings of subsidiaries operating outside the United States that are intended to be indefinitely reinvested. These unremitted earnings aggregated approximately $520 million at year-end 1989, exclusive of amounts that if remitted in the future would result in little or no tax under current tax laws and the amended Puerto Rican tax incentive grant.

Reconciliation of the U.S. federal statutory tax rate to PepsiCo's effective tax rate on income from continuing operations:

	1989	1988	1987
U.S. federal statutory tax rate	**34.0%**	34.0%	40.0%
State income tax net of federal tax benefit	**2.0**	2.2	4.3
Earnings in jurisdictions taxed at lower rates (principally Puerto Rico and Ireland)	**(3.9)**	(3.7)	(7.9)
Nondeductible amortization of goodwill and other intangibles	**2.0**	1.4	0.8
Other, net	**(0.8)**	(1.5)	(1.2)
Effective tax rate	**33.3%**	32.4%	36.0%

Deferred income taxes reflected in the Consolidated Balance Sheet:

	1989	1988
Included in:		
"Deferred Income Taxes"		
– Timing differences	**$635.9**	$564.6
– Safe Harbor leases	**221.0**	236.3
	$856.9	$800.9
"Other current liabilities"	**$ 8.2**	$ –
"Prepaid expenses, taxes and other current assets"	**$ –**	$ 20.4

In 1981 and 1982 PepsiCo invested in Safe Harbor leases (the Leases), which effectively are financing transactions that decrease income taxes payable over the initial years of the Leases and increase them over the later years. The deferred federal income taxes payable related to the Leases are based on the current U.S. federal statutory tax rate. Taxes payable related to the Leases are estimated to be $54 million over the next five years.

In December 1989 the Financial Accounting Standards Board (the FASB) amended Statement No. 96 (SFAS 96) on Accounting for Income Taxes to extend the required adoption date. PepsiCo currently intends to adopt SFAS 96 as required in the first quarter of 1992. As the FASB continues to review and evaluate possible amendments to the statement, PepsiCo is unable to predict the final FASB requirements and therefore cannot reasonably estimate the effect of adoption on net income.

Supplemental Cash Flow Information

	1989	1988	1987
Cash Flow Data:			
Interest paid	**$591.1**	$286.5	$257.7
Income taxes paid	**$239.7**	$234.7	$222.2
Schedule of Noncash Investing and Financing Activities:			
Issuance of treasury stock and debt for acquisitions	**$103.9**	$328.2	$ –
Liabilities assumed/ disposed of in connection with acquisitions/sales of businesses	**$446.8**	$300.0	$ 45.0
Issuance of treasury stock for compensation awards and conversion of debentures	**$ 9.3**	$ 26.4	$ 14.8
Additions of capital leases	**$ 15.7**	$ 4.3	$ 4.5

Retirement Plans

PepsiCo has several noncontributory defined benefit pension plans covering substantially all full-time domestic employees. Benefits for salaried employees generally are based on years of service and the employees' highest consecutive five-year average annual earnings. Benefits for hourly employees generally are based on specified amounts and credited service. PepsiCo funds these plans in amounts not less than minimum statutory funding requirements nor more than the maximum amount that can be deducted for federal income tax purposes. The plans' assets consist principally of equity securities, government and corporate debt securities and other fixed income obligations. Capital Stock of PepsiCo accounted for approximately 16.8% and 12.5% of the total market value of the plans' assets at year-end 1989 and 1988, respectively.

The net pension credit for company-sponsored domestic plans (the Plans) included the following components:

	1989	1988	1987
Service cost of benefits earned	**$ 32.0**	$ 24.8	$ 29.5
Interest cost on projected benefit obligation	**47.1**	40.0	38.1
Return on the Plans' assets:			
Actual	**(154.6)**	(86.1)	(50.9)
Deferred gain (loss)	**89.9**	23.5	(9.2)
	(64.7)	(62.6)	(60.1)
Amortization of net transition gain	**(19.0)**	(19.0)	(19.0)
Pension credit	**$ (4.6)**	$(16.8)	$(11.5)

In determining the 1989, 1988 and 1987 pension credits, the assumed discount rates were 10.1%, 10.0% and 8.6%, respectively, and the expected long-term rate of return applied to the market-related value of the Plans' assets was 10.0% for each of the three years.

Reconciliations of the funded status of the Plans to the prepaid or accrued pension liability included in the Consolidated Balance Sheet are as follows:

	1989	1988
Actuarial present value of benefit obligations:		
Vested benefits	**$(449.0)**	$(314.0)
Nonvested benefits	**(75.0)**	(73.3)
Accumulated benefit obligation	**(524.0)**	(387.3)
Effect of projected compensation increases	**(92.1)**	(57.0)
Projected benefit obligation	**(616.1)**	(444.3)
Plan assets at fair value	**869.8**	708.5
Plan assets in excess of projected benefit obligation	**253.7**	264.2
Unrecognized prior service cost	**26.2**	3.4
Unrecognized net gain	**(104.0)**	(97.1)
Unrecognized net transition gain	**(167.1)**	(186.1)
Prepaid (accrued) pension liability	**$ 8.8**	$ (15.6)
Included in:		
"Investments, Long-term Receivables and Other Assets"	**$ 31.2**	$ 3.4
"Other current liabilities"	**(14.3)**	(10.8)
"Other Liabilities and Deferred Credits"	**(8.1)**	(8.2)
	$ 8.8	$ (15.6)

The determination of the actuarial present value of the projected benefit obligation at year-end 1989 and 1988 reflected assumed discount rates of 9.0% and 10.1%, respectively, and future compensation growth rates within a range of 5.0% to 7.0% for both years. For certain plans accumulated benefits exceeded the assets, but the related amounts were not significant.

Full-time domestic employees not covered by the Plans generally are covered by multiemployer plans as part of collective-bargaining agreements. Pension expense for these multiemployer plans was not significant in the aggregate.

Pension coverage for employees of PepsiCo's foreign operations is provided through separate plans, many of which are governed by local statutory requirements. The majority of the employees of the recently acquired Smiths and Walkers businesses are covered under pension plans provided by a former owner that also cover other businesses. Pension expense and the required disclosures under SFAS 87 related to the Smiths and Walkers employees covered by these plans are not determinable until the allocation of the assets of these plans, the transfer of relevant employees to separate Smiths and Walkers plans, and actuarial valuations are completed in 1990. Plans of other foreign operations were not significant in the aggregate and therefore were not included in the above disclosures. 1989 pension expense for these other company-sponsored foreign plans approximated pension expense under SFAS 87. No individual foreign plan was significantly over or underfunded at year-end 1989.

PepsiCo provides certain health care and life insurance benefits to retired nonunion employees. The annual costs of these benefits, which are currently not significant, are expensed as health care claims are incurred and life insurance premiums are paid.

Employee Incentive Plans

In 1989 PepsiCo established the PepsiCo SharePower Stock Option Plan. Under this plan, which was approved by the Board of Directors, all employees who meet certain eligibility requirements may be granted stock options. Executive officers, part-time and short-service employees principally comprise the non-eligible group. Executive officers may be granted similar benefits under the 1987 Long-Term Incentive Plan. A stock option represents the right to purchase one share of PepsiCo Capital Stock at the fair market value on the date of the grant. The number of options granted is based on a percentage of the employee's annual earnings. The grants may be made annually, have a term of 10 years from the grant date and generally become exercisable ratably over the five years after the grant date. The first grant, on July 5, 1989, consisted of 3,580,569 options awarded to approximately 75,000 employees.

The shareholder-approved 1987 Long-Term Incentive Plan (the Plan), effective January 1, 1988, continues the principal features of the 1979 Incentive Plan that expired on December 31, 1987. The Plan provides long-term incentives to key employees through stock options, performance shares and stock appreciation rights (SARs). The Plan also provides incentive stock units (Units) and, beginning in 1989, stock options to eligible middle management employees. The Plan authorizes up to a maximum of 18 million shares of PepsiCo Capital Stock to be purchased or paid pursuant to grants by the Compensation Committee of the Board of Directors (the Committee), which is composed of outside directors. Payment of awards other than stock options is made in cash and/or PepsiCo Capital Stock as determined by the Committee.

Under the Plan, a stock option is exercisable for a specified period generally falling between 1 and 15 years from the date of grant. A performance share, equivalent to one share of PepsiCo Capital Stock, generally vests and is payable four years after the date of grant, contingent upon attainment of prescribed performance criteria. Employees may receive partial performance share awards if they become eligible for new or increased awards subsequent to a grant. A stock option is granted with each performance share. Beginning with the 1988 award, a specified number of additional stock options are granted in lieu of a performance share. These additional stock options may be converted to a performance share at the employee's election within 60 days from the date of grant. In January 1990, 3,510,344 stock options were granted to senior management, of which 2,632,758 are convertible to 877,586 performance shares.

SARs, available to certain senior management employees holding stock options, may be granted in the year the related options become exercisable. They allow the employees to surrender an option for an amount equal to the appreciation between the option exercise price and the fair market value of PepsiCo Capital Stock on the date the SAR is exercised. SARs expire no later than the expiration date of the related options. Beginning in 1989 the maximum number of stock options that can be surrendered for SARs is 30% of outstanding options that have been exercisable longer than one year. SARs outstanding at year-end 1989 and 1988 were 56,318 and 205,849, respectively. In January 1990, 42,099 SARs were granted.

A Unit, equivalent to one share of PepsiCo Capital Stock, vests over a six-year period from the date of grant, and the value is based on the fair market value of PepsiCo Capital Stock at specified vesting dates. The last of the Unit awards were granted in 1988.

The estimated costs of performance shares, SARs and Units, expensed over the applicable vesting periods of the awards, were $25 million, $16 million and $20 million in 1989, 1988 and 1987, respectively.

Award activity for 1989 and 1988 was as follows:

	SharePower Plan	Long-Term Incentive Plans		
	Stock Options	Stock Options	Performance Shares	Incentive Stock Units
		(000's)		
Outstanding at December 26, 1987	–	**3,142**	**1,769**	**562**
Granted	–	3,684	87	7
Exercised/Paid	–	(194)	(1,018)	(15)
Surrendered for performance shares	–	(542)	181	–
Surrendered for SARs	–	(116)	–	–
Cancelled	–	(147)	(46)	(96)
Outstanding at December 31, 1988	–	**5,827**	**973**	**458**
Granted	3,581	703	5	–
Exercised/Paid	–	(205)	–	(194)
Surrendered for performance shares	–	(16)	5	–
Surrendered for SARs	–	(10)	–	–
Cancelled	(232)	(191)	(49)	(40)
Outstanding at December 30, 1989	**3,349**	**6,108**	**934**	**224**
Exercisable at December 30, 1989	**9**	**635**		
Option prices per share:				
Exercised during 1989	–	$12.33 to $26.25		
Exercised during 1988	–	$12.33 to $26.25		
Outstanding at year-end 1989	$52.75	$12.33 to $60.00		

Included in the above Long-Term Incentive Plans grant activity are 283,595 stock options granted to middle management employees in 1989, none of which were exercisable at year-end 1989.

Contingencies

PepsiCo is involved in various claims and legal proceedings, the resolution of which management believes will not have a material effect on PepsiCo's business or financial condition. PepsiCo intends to prosecute or defend vigorously, as the case may be, all such matters.

At year-end 1989 PepsiCo was contingently liable under direct and indirect guarantees aggregating $65 million.

Management's Responsibility for Financial Statements

To Our Shareholders:

Management is responsible for the preparation, integrity and objectivity of the consolidated financial statements and related notes. To meet these responsibilities, we maintain a system of internal control, supported by formal policies and procedures, which include an active Code of Conduct program intended to ensure key employees adhere to the highest standards of personal and professional integrity. PepsiCo's internal audit function monitors and reports on the adequacy of and compliance with our internal controls, policies and procedures. Although no cost effective internal control system will preclude all errors and irregularities, we believe the established system of internal control provides reasonable assurance that assets are safeguarded, transactions are recorded in accordance with our policies and the financial information is reliable.

The consolidated financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis, and include amounts based upon our estimates and judgments, as required. The consolidated financial statements have been audited by Ernst & Young who have expressed their opinion, presented below, with respect to the fairness of the statements. Their audits included a review of the system of internal control and tests of transactions to the extent they considered necessary to render their opinion.

The Audit Committee of the Board of Directors is composed solely of outside directors. The Audit Committee meets periodically with our independent auditors, PepsiCo internal auditors and management to review accounting, auditing, internal control and financial reporting matters. Both our independent auditors and internal auditors have free access to the Audit Committee.

Wayne Calloway

Wayne Calloway
Chairman of the Board and Chief Executive Officer

Robert G. Dettmer

Robert G. Dettmer
Executive Vice President and Chief Financial Officer

Robert L Carleton

Robert L. Carleton
Senior Vice President and Controller

Report of Ernst & Young Independent Auditors

Board of Directors and Shareholders
PepsiCo, Inc.

We have audited the accompanying consolidated balance sheet of PepsiCo, Inc. and subsidiaries as of December 30, 1989 and December 31, 1988, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 30, 1989, appearing on pages 34, 35, 36, 38, 40, 42 through 48. These financial statements are the responsibility of PepsiCo, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of PepsiCo, Inc. and subsidiaries at December 30, 1989 and December 31, 1988, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 30, 1989 in conformity with generally accepted accounting principles.

Ernst + Young

New York, New York
February 6, 1990

Selected Financial Data

(in millions except per share, shareholder and employee amounts, unaudited) PepsiCo, Inc. and Subsidiaries	Growth Rates Compounded 10-Year 1979-89	Compounded 5-Year 1984-89(c)	Annual 1-Year 1988-89	1989	1988
Summary of Operations					
Net sales	13.8%	16.6%	21.6%	**$15,242.4**	$12,533.2
Cost of sales and operating expenses				**13,459.5**(c)	11,184.0
Interest expense				**609.6**	344.2
Interest income				**(177.2)**	(122.2)
				13,891.9	11,406.0
Income from continuing operations before income taxes				**1,350.5**	1,127.2
Provision for income taxes				**449.1**	365.0
Income from continuing operations	14.2%	26.3%	18.3%	**$ 901.4**	$ 762.2
Net income	13.7%	33.5%	18.3%	**$ 901.4**	$ 762.2
Income per share from continuing operations	14.7%	28.0%	17.2%	**$ 3.40**(c)	$ 2.90
Net income per share	14.2%	35.3%	17.2%	**$ 3.40**	$ 2.90
Cash dividends declared per share	10.1%	11.6%	20.0%	**$ 0.960**	$ 0.800
Average shares and equivalents outstanding				**265.3**	263.5
Cash Flow Data(e)					
Net cash generated by continuing operations	15.2%	14.0%	(0.5)%	**$ 1,885.9**	$ 1,894.5
Acquisitions and equity investments for cash				**$ 3,296.6**	$ 1,415.5
Purchases of property, plant and equipment for cash	9.3%	11.2%	30.0%	**$ 943.8**	$ 725.8
Cash dividends paid	9.3%	9.4%	21.6%	**$ 241.9**	$ 199.0
Year-End Position					
Total assets				**$15,126.7**	$11,135.3
Total debt(f)				**$ 6,942.8**	$ 4,107.0
Shareholders' equity				**$ 3,891.1**	$ 3,161.0
Per share	11.3%	17.5%	22.7%	**$ 14.76**	$ 12.03
Market price per share	22.6%	35.5%	62.0%	**$ 64**	$ 39½
Shares outstanding				**263.7**	262.8
Employees				**266,000**	235,000
Shareholders of record				**95,000**	94,000
Statistics					
Return on average shareholders' equity(g)				**25.6%**	26.9%
Return on net sales(g)				**5.9%**	6.1%
Net debt ratio(h)				**51%**	37%

Certain 1988 and 1987 amounts in the Summary of Operations above have been restated. (See Note to Consolidated Financial Statements on page 43.)

(a) PepsiCo adopted the Financial Accounting Standard (SFAS) No. 87 on Employers' Accounting for Pensions. Prior years are not restated for SFAS 87.

(b) PepsiCo adopted the Financial Accounting Standard (SFAS) No. 52 on Foreign Currency Translation. Prior years are not restated for SFAS 52.

(c) In 1984 a $156.0 charge ($62.0 after-tax or $0.22 per share) was recorded related to a program to sell several company-owned foreign bottling operations. In 1985 a $25.9 credit ($14.9 after-tax or $0.05 per share) was recorded to reflect better than anticipated results from the program. In 1989, an additional $32.5 credit ($21.5 after-tax or $0.08 per share) was recorded related to a decision to retain one of the foreign bottling operations previously held for sale.

(d) Included a $79.4 charge ($79.4 after-tax or $0.28 per share) related to a reduction in net assets of certain foreign bottling operations.

(e) PepsiCo adopted the Financial Accounting Standard (SFAS) No. 95 on Reporting of Cash Flows in 1988. Years prior to 1986 are not restated for SFAS 95. Cash flows from other investing and financing activities, which are not presented, are an integral part of total cash flow activity.

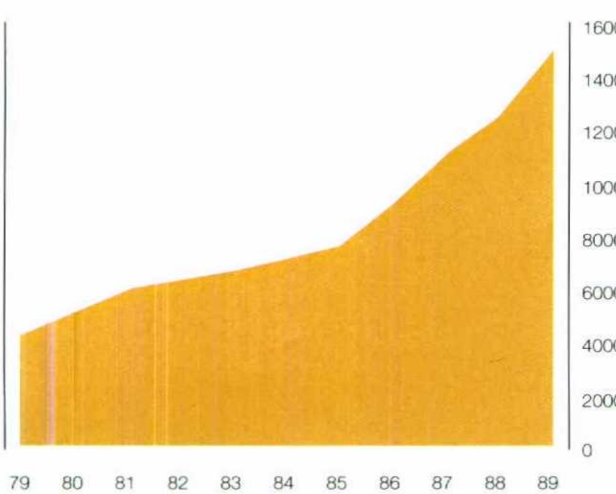
(f) Total debt includes short-term borrowings, long-term debt and the nonrecourse obligation. (See Note to Consolidated Financial Statements on page 45.)

(g) The return on average shareholders' equity and return on net sales are calculated using income from continuing operations.

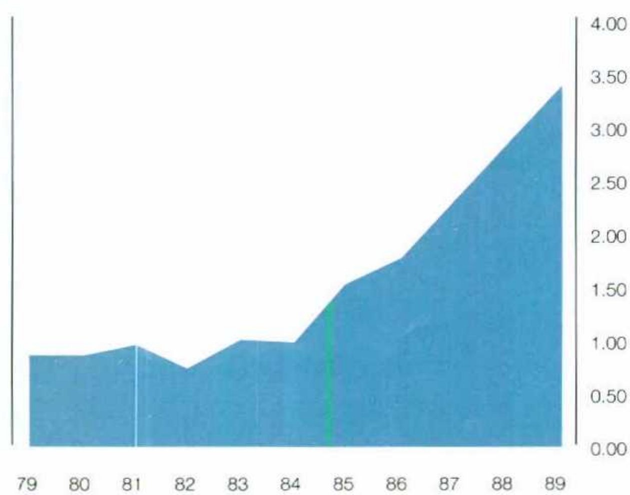
(h) The net debt ratio represents total debt (excluding the nonrecourse obligation), reduced by the pro forma remittance of offshore investment portfolios, as a percent of capital employed (net debt, other liabilities and deferred credits, deferred income taxes and shareholders' equity).

	1987(a)	1986	1985	1984	1983	1982(b)	1981	1980	1979
	$11,018.1	$9,017.1	$7,584.5	$7,058.6	$6,568.6	$6,232.4	$5,873.3	$4,955.9	$4,198.9
	9,890.5	8,187.9	6,802.4(c)	6,479.3(c)	5,995.7	5,684.7(d)	5,278.8	4,435.7	3,734.7
	294.6	261.4	195.2	204.9	175.0	163.5	147.7	112.7	71.2
	(112.6)	(122.7)	(96.4)	(86.1)	(53.6)	(49.1)	(35.8)	(27.1)	(21.9)
	10,072.5	8,326.6	6,901.2	6,598.1	6,117.1	5,799.1	5,390.7	4,521.3	3,784.0
	945.6	690.5	683.3	460.5	451.5	433.3	482.6	434.6	414.9
	340.5	226.7	256.7	180.5	169.5	229.7	213.7	200.3	176.3
	$ 605.1	$ 463.8	$ 426.6	$ 280.0	$ 282.0	$ 203.6	$ 268.9	$ 234.3	$ 238.6
	$ 594.8	$ 457.8	$ 543.7	$ 212.5	$ 284.1	$ 224.3	$ 297.5	$ 260.7	$ 250.4
	$ 2.30	$ 1.77	$ 1.53(c)	$ 0.99(c)	$ 1.00	$ 0.73(d)	$ 0.97	$ 0.86	$ 0.86
	$ 2.26	$ 1.75	$ 1.94	$ 0.75	$ 1.00	$ 0.80	$ 1.07	$ 0.95	$ 0.90
	$ 0.670	$ 0.628	$ 0.585	$ 0.555	$ 0.540	$ 0.527	$ 0.473	$ 0.420	$ 0.368
	263.1	262.2	280.7	287.5	286.4	284.7	279.2	273.5	278.4
	$ 1,334.5	$1,212.2	$ 817.3	$ 981.5	$ 670.2	$ 661.5	$ 515.0	$ 458.3	$ 459.3
	$ 371.5	$1,679.9	$ 160.0	$ –	$ –	$ 130.3	$ –	$ –	$ –
	$ 770.5	$ 858.5	$ 770.3	$ 555.8	$ 503.4	$ 447.4	$ 414.4	$ 447.4	$ 386.9
	$ 172.0	$ 160.4	$ 161.1	$ 154.6	$ 151.3	$ 142.5	$ 126.2	$ 111.2	$ 99.7
	$ 9,022.7	$8,027.1	$5,889.3	$4,876.9	$4,446.3	$4,052.2	$3,960.2	$3,309.7	$2,800.0
	$ 3,225.0	$2,865.3	$1,506.1	$ 948.9	$1,073.9	$1,033.5	$1,214.0	$ 888.6	$ 682.2
	$ 2,508.6	$2,059.1	$1,837.7	$1,853.4	$1,794.2	$1,650.5	$1,556.3	$1,509.7	$1,387.2
	$ 9.63	$ 7.91	$ 6.98	$ 6.58	$ 6.39	$ 5.89	$ 5.66	$ 5.51	$ 5.08
	$ 33⅞	$ 26¼	$ 23¾	$ 14	$ 12¾	$ 11⅓	$ 12⅛	$ 8⅔	$ 8⅓
	260.4	260.3	263.1	281.7	280.7	280.1	274.8	273.8	272.9
	225,000	214,000	150,000	150,000	154,000	133,000	120,000	111,000	105,000
	92,000	87,000	72,000	62,000	60,000	48,000	49,000	51,000	53,000
	26.5%	23.8%	23.1%	15.4%	16.4%	12.7%	17.5%	16.2%	17.5%
	5.5%	5.1%	5.6%	3.9%	4.3%	3.3%	4.6%	4.7%	5.7%
	35%	40%	24%	11%	23%	30%	38%	32%	29%

Net Sales
($ In Millions)



Income Per Share From Continuing Operations
(In Dollars)



Quarterly Financial Data

(in millions except per share amounts, unaudited)

	First Quarter		Second Quarter		Third Quarter		Fourth Quarter		Full Year	
	1989	1988	**1989**	1988	**1989**	1988	**1989**	1988	**1989**	1988
Net sales	**$2,958.3**	2,478.9	**3,592.7**	2,898.8	**3,901.6**	3,129.8	**4,789.8**	4,025.7	**15,242.4**	12,533.2
Gross profit	**$1,529.7**	1,310.8	**1,854.8**	1,547.8	**1,976.1**	1,647.0	**2,414.1**	2,070.2	**7,774.7**	6,575.8
Income before income taxes	**$ 252.1**	168.4[a]	**396.5[b]**	323.1	**406.2**	358.5[c]	**295.7[d]**	277.2	**1,350.5**	1,127.2
Provision for income taxes	**$ 87.0**	55.1	**131.6**	103.5	**136.9**	116.9	**93.6**	89.5	**449.1**	365.0
Net income	**$ 165.1**	113.3	**264.9**	219.6	**269.3**	241.6	**202.1**	187.7	**901.4**	762.2
Net income per share	**$ 0.62**	0.43[a]	**1.00[b]**	0.84	**1.02**	0.91[c]	**0.76[d]**	0.72	**3.40**	2.90

The first, second and third quarters of 1989 and 1988 each consisted of 12 weeks. The fourth quarter of 1989 and 1988 consisted of 16 and 17 weeks, respectively. Full years 1989 and 1988 consisted of 52 and 53 weeks, respectively.

The 1988 amounts have been restated to report under the equity method of accounting certain previously consolidated foreign joint ventures of Kentucky Fried Chicken due to a reduction in PepsiCo's voting interest in early 1989. (See Note to Consolidated Financial Statements on page 43.)

(a) Included a $14.5 charge ($10.4 after-tax or $0.04 per share) related to a reorganization of domestic soft drinks operations.

(b) Included a net credit of $22.2 ($15.0 after-tax or $0.06 per share) consisting primarily of a credit of $32.5 resulting from a decision to retain a foreign bottling operation previously held for sale, partially offset by an $8.0 charge related to a reorganization of Kentucky Fried Chicken's domestic operations.

(c) Included a $9.4 loss ($5.9 after-tax or $0.02 per share) resulting from the sale of a winery in Spain.

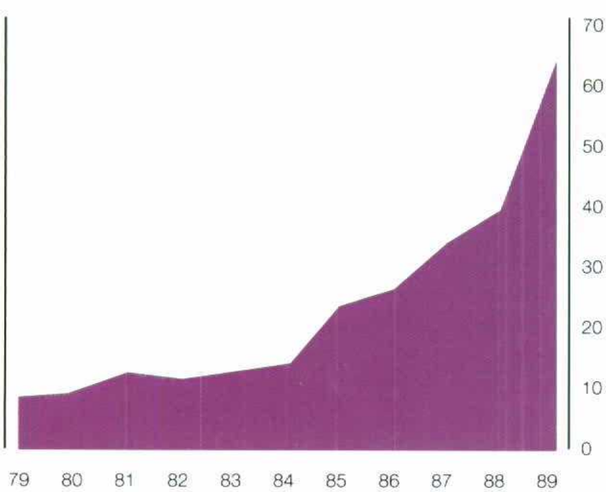
(d) Included a $17.8 charge ($13.2 after-tax or $0.05 per share) consisting of a $12.3 charge related to a reorganization of international soft drinks operations and a $5.5 charge related to a reorganization of domestic Taco Bell operations.

Stock Performance

PepsiCo was formed through the 1965 merger of Pepsi-Cola Company and Frito-Lay, Inc. A $1,000 investment in our stock made in 1965 was worth approximately $31,000 on December 30, 1989, assuming the reinvestment of dividends. Past performance is not necessarily indicative of future returns on investments in PepsiCo Capital Stock.

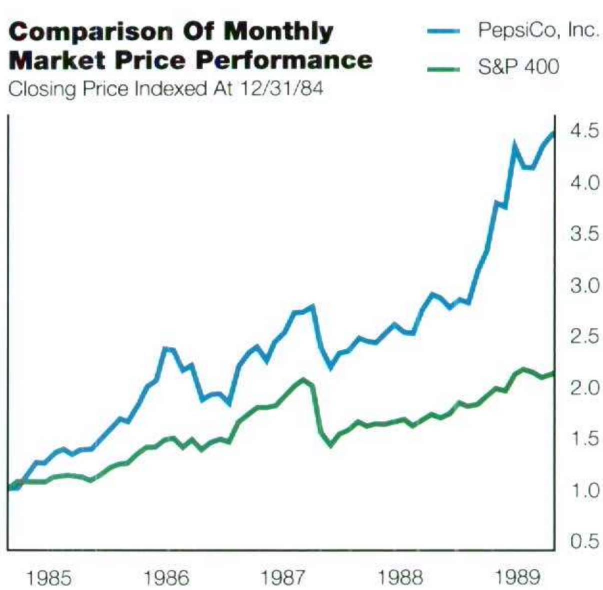
As the chart below illustrates, the return on PepsiCo Capital Stock compares favorably with the performance of the Standard & Poor's 400 over the past five years.

Year-End Market Price Of Stock
(In Dollars)



The market price of PepsiCo Capital Stock has grown at a compounded annual rate of 22.6% over the last 10 years.

Comparison Of Monthly Market Price Performance
Closing Price Indexed At 12/31/84



Over the past five years, the market price of PepsiCo Capital Stock has increased at more than twice the rate of the Standard & Poor's 400.

Capital Stock Information

Stock Trading Symbol

PEP

Stock Exchange Listings

New York, Midwest, Basel,
Geneva, Zurich, Amsterdam, Tokyo

At year-end 1989 there were approximately 95,000 shareholders of record.

Dividend Policy

Cash dividends are declared quarterly. Quarterly cash dividends have been paid since PepsiCo was formed in 1965, and dividends have increased for 18 consecutive years.

The 1989 dividend payout ratio was 33% of 1988 earnings.

Dividends Declared Per Share

Quarter	1989	1988
1	21¢	17¢
2	25	21
3	25	21
4	25	21
Total	96¢	80¢

Dividend Reinvestment Plan

Shareholders may increase their investment in our stock by enrolling in PepsiCo's Dividend Reinvestment Plan. A brochure explaining this convenient plan, for which PepsiCo pays all fees, is available from our transfer agent:

Manufacturers Hanover Trust Company
450 West 33rd Street
New York, New York 10001

Stock Prices

The high, low and closing prices on the New York Stock Exchange, as reported by The Dow Jones News/Retrieval Service, for each fiscal quarter of 1989 and 1988 were as follows (in dollars):

1989	High	Low	Close
Fourth Quarter	**65 7/8**	**53 7/8**	**64**
Third Quarter	**62 3/8**	**51 1/8**	**56 1/4**
Second Quarter	**55 1/4**	**42 5/8**	**51 3/4**
First Quarter	**44 1/8**	**37 3/4**	**43 1/2**
1988			
Fourth Quarter	43 5/8	36 1/2	39 1/2
Third Quarter	38	33 1/2	36 1/2
Second Quarter	37 3/4	32 3/4	37
First Quarter	35 7/8	30	35

Shareholder Information

Financial Information

Security analysts and representatives of financial institutions are invited to contact:

Margaret D. Moore
Vice President, Investor Relations
Telephone: (914) 253-3035

Shareholder Inquiries

Questions concerning your dividend reinvestment account, dividend payments or address changes should be addressed to:

Manufacturers Hanover Trust Company
Security Holder Relations
P.O. Box 24935, Church Street Station
New York, New York 10249
Telephone: (212) 613-7147

Please mention PepsiCo, your name as printed on your stock certificate, your social security number and include your address and telephone number in all correspondence.

Shareholders' Meeting

The Annual Meeting of Shareholders will be held at PepsiCo World Headquarters on Anderson Hill Road, Purchase, New York, at 10 a.m. (EDT), Wednesday, May 2, 1990. Proxies for the meeting will be solicited by an independent proxy solicitor. This Annual Report is not part of the proxy solicitation.

If you need additional assistance or information, or would like to receive free of charge a copy of PepsiCo's Form 10-K and 10-Q reports filed with the Securities and Exchange Commission, contact:

Manager of Shareholder Relations
PepsiCo, Inc.
Purchase, New York 10577
Telephone: (914) 253-3055

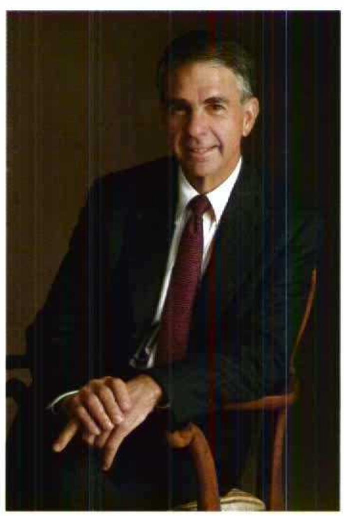
PepsiCo Directors

Roger A. Enrico
President and Chief Executive Officer
PepsiCo Worldwide Beverages, 45
Elected 1987
Committee: Executive

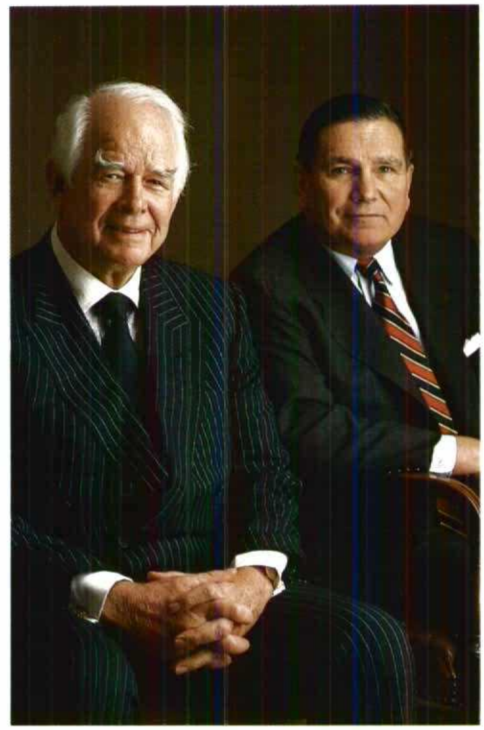
Wayne Calloway
Chairman of the Board
and Chief Executive Officer
PepsiCo, Inc., 54
Elected 1983
Committee: Executive

Sharon Percy Rockefeller
President and Chief Executive Officer
WETA public stations, 45
Elected 1986
Committees: Audit, Compensation

Roger B. Smith
Chairman of the Board
and Chief Executive Officer
General Motors Corp., 64
Elected 1989
Committees: Audit, Compensation



Robert E. Allen
Chairman of the Board
and Chief Executive Officer
AT&T, 55
Elected 1990
Committees: Audit, Compensation



Donald M. Kendall
Chairman of the Executive
Committee (Retired Chairman of the
Board and Chief Executive Officer
PepsiCo, Inc.), 69
Elected 1961
Committees: Audit, Compensation

Robert H. Stewart, III
Vice Chairman of the Board
Team Bank, 64
Elected 1965
Committees: Audit, Executive,
Compensation (Chairman)

Clifton C. Garvin, Jr.
Retired Chairman of the Board
and Chief Executive Officer
Exxon Corporation, 68
Elected 1975
Committees: Compensation,
Executive, Audit (Chairman)

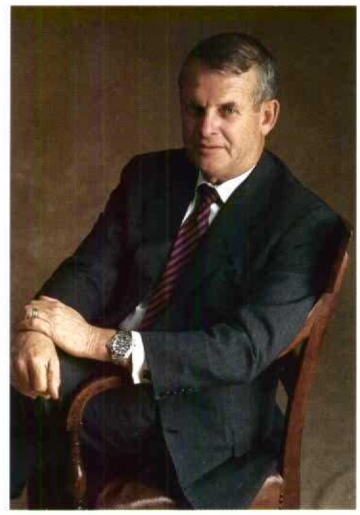
Andrall E. Pearson
Professor, Harvard Business
School (Retired President and
Chief Operating Officer,
PepsiCo, Inc.), 64
Elected 1970
Committees: Audit, Compensation

Arnold R. Weber
President, Northwestern
University, 60
Elected 1978
Committees: Audit, Compensation

Frank T. Cary
Retired Chairman of the Board
and Chief Executive Officer
International Business
Machines Corporation, 69
Elected 1983
Committees: Audit,
Compensation, Executive

Michael H. Jordan
President and Chief Executive Officer
PepsiCo Worldwide Foods, 53
Elected 1985
Committee: Executive

William T. Coleman, Jr.
Senior Partner
O'Melveny & Myers, 69
Elected 1977
Committees: Audit, Compensation



John J. Murphy
Chairman of the Board,
Chief Executive Officer
and President
Dresser Industries, 58
Elected 1984
Committees: Audit,
Compensation

Principal Divisions and Corporate Officers

(Listings for Division Presidents and Executive Officers include age and PepsiCo experience.)

Soft Drinks

PepsiCo Worldwide Beverages
Somers, New York 10589
Roger A. Enrico, President, 45,
19 years at Pepsi-Cola Company, Frito-Lay, Pepsi-Cola International, PepsiCo Foods International

Pepsi-Cola Company
Craig E. Weatherup, President, 44,
16 years at Pepsi-Cola Company, Pepsi-Cola International

Pepsi-Cola International
Christopher A. Sinclair, President, 39,
8 years at Pepsi-Cola International, Pepsi-Cola Company, Frito-Lay

Snack Foods

PepsiCo Worldwide Foods
7701 Legacy Drive
Plano, Texas 75024
Michael H. Jordan, President, 53,
16 years at Corporate, Frito-Lay, PepsiCo Foods International, Pepsi-Cola International

Frito-Lay, Inc.
Robert H. Beeby, President, 58,
18 years at Frito-Lay, Pepsi-Cola International

PepsiCo Foods International
400 Frito-Lay Tower
Dallas, Texas 75235
John S. Pingel, Jr., President, 48,
19 years at PepsiCo Foods International, Pepsi-Cola International, Pepsi-Cola Company

Restaurants

Kentucky Fried Chicken Corporation
1441 Gardiner Lane
Louisville, Kentucky 40213
John M. Cranor III, President, 43,
13 years at Kentucky Fried Chicken, Pepsi-Cola Company, Taco Bell, Frito-Lay

Pizza Hut, Inc.
9111 East Douglas
Wichita, Kansas 67207
Steven S Reinemund, President, 41,
6 years at Pizza Hut

Taco Bell Corp.
17901 Von Karman
Irvine, California 92714
John E. Martin, President, 44,
7 years at Taco Bell

PepsiCo Food Service International
Purchase, New York 10577
Graham G. Butler, President, 50,
18 years at PepsiCo Food Service International, Pizza Hut, Pepsi-Cola International

Executive Officers

Wayne Calloway
Chairman of the Board and Chief Executive Officer, 54,
23 years at Corporate, Frito-Lay, Pepsi-Cola International

Donald M. Kendall
Chairman, Executive Committee, 69,
45 years at Corporate, Pepsi-Cola Company, Pepsi-Cola International

Roger A. Enrico
President and Chief Executive Officer
PepsiCo Worldwide Beverages

Michael H. Jordan
President and Chief Executive Officer
PepsiCo Worldwide Foods

Robert G. Dettmer
Executive Vice President and Chief Financial Officer, 58,
17 years at Corporate, Pepsi-Cola Company

Randall C. Barnes
Senior Vice President, Strategic Planning and New Business Development, 38,
3 years at Corporate

Robert L. Carleton
Senior Vice President and Controller, 49,
15 years at Corporate

Donovan R. Christopherson
Senior Vice President, Restaurant Development, 57, 9 years at Corporate

J. Roger King
Senior Vice President, Personnel, 49,
20 years at Corporate, Pizza Hut, Frito-Lay

Edward V. Lahey, Jr.
Senior Vice President, General Counsel and Secretary, 51,
25 years at Corporate

Joseph F. McCann
Senior Vice President, Public Affairs, 49,
18 years at Corporate, Pepsi-Cola Company, Frito-Lay

Leonard Schutzman
Senior Vice President and Treasurer, 43,
13 years at Corporate, Frito-Lay, Pepsi-Cola International, Taco Bell

Vice Presidents

Robert O. Barber
Assistant Controller

John T. Cahill
Assistant Treasurer

Gerard W. Casey
Associate General Counsel

Douglas M. Cram
Assistant General Counsel

Allan B. Deering
Management Information Services

Lawrence F. Dickie
Associate General Counsel and Assistant Secretary

Robert S. Enright
Taxes

William A. Finkelstein
Intellectual Property Counsel

John J. Flaherty
General Auditor

James M. Griffith
Public Relations

Donald T. Haman
Tax Administration

Joseph J. Joyce
Assistant General Counsel

Fred S. McRobie
Assistant General Counsel

Margaret D. Moore
Investor Relations

Claudia E. Morf
Assistant Treasurer

Charles W. Rogers
Compensation and Benefits

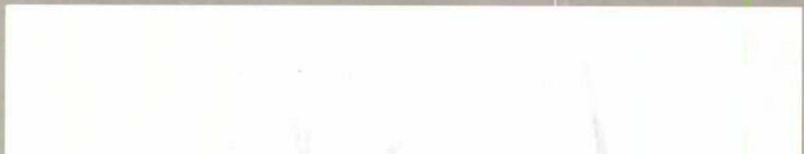
David E. Scherb
Benefits

David L. Wright
Government Affairs

Executive Offices

Purchase, New York 10577
(914) 253-2000

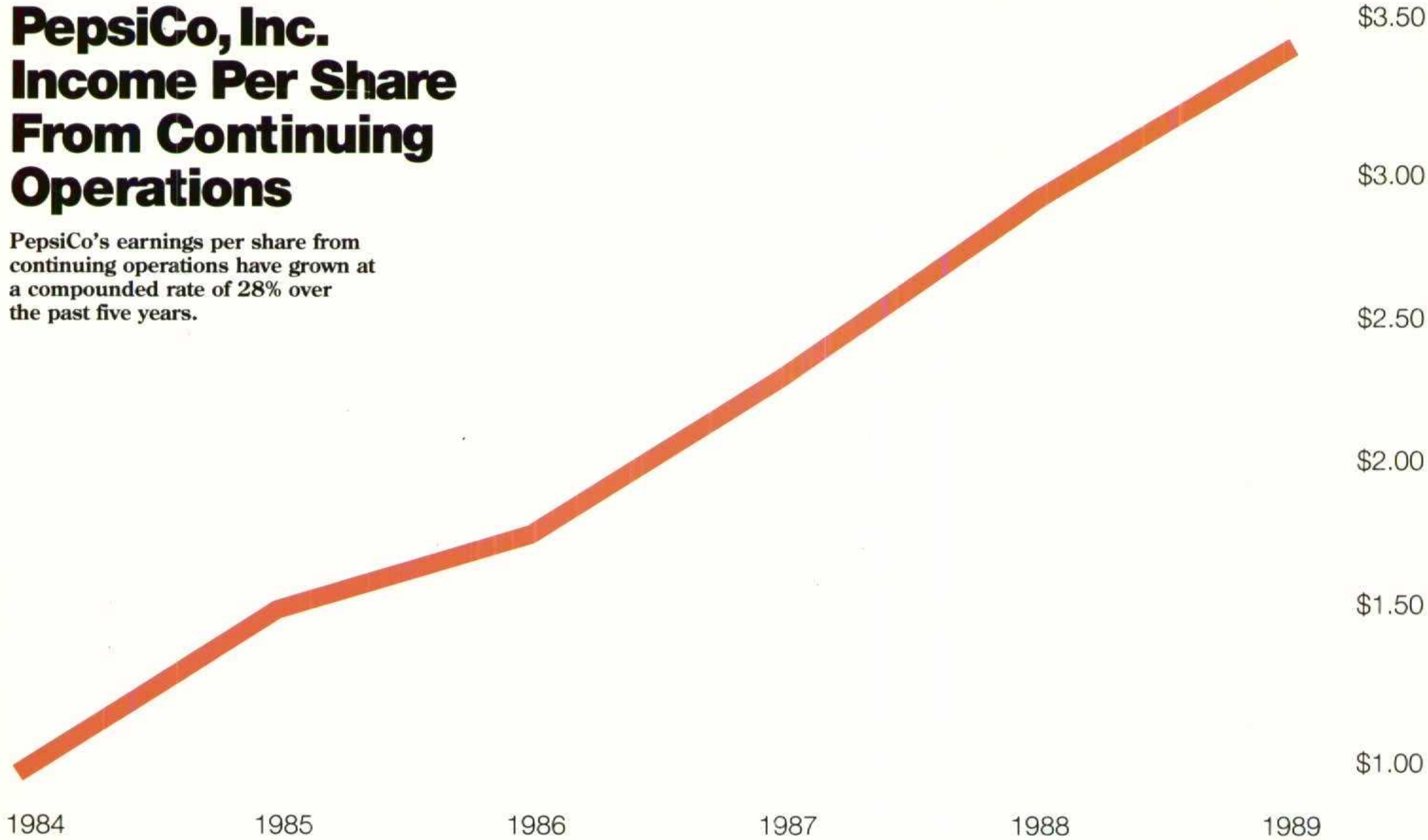
Design: Eisenman & Enock, Inc.
Printing: The Bradley Printing Company
Typography: Production Typographers, Inc.
Major Photography: Stephen Wilkes
Chairman's and Directors' Photography: Alen MacWeeney, Brian Coats



W^e hope we've demonstrated in this Annual Report that acing change is key to PepsiCo's success. But doing new fferent things can occasionally cause some uncomfortable ions. Here's what happened when we first asked five of the est membe of the Pepsi Generation to pose for our cover. rtunately, with a little encouragement from senior m agement (Mom), they eventually got it right.

PepsiCo, Inc. Income Per Share From Continuing Operations

PepsiCo's earnings per share from continuing operations have grown at a compounded rate of 28% over the past five years.



PepsiCo, Inc., Purchase, New York 10577